STATE OF CALIFORNIA
DEPARTMENT OF INSURANCE
45 Fremont Street
San Francisco, CA 94105

RH05049799 **January 5, 2007**

Title 10, Article 7.1
Proposed Sections 2355.1-2359.7
Title Insurance and Statistical Plan

VOLUME 7
(Bates Pages 2497-2896)

Summary and Response to Comments Received During 45-Day Comment Period

Pursuant to Gov. Code § 11346.9(a)(3), repetitive comments are aggregated, summarized and responded to as a group. Comments which were not specifically directed at the proposed regulations or procedures followed in proposing the regulations are irrelevant and have been dismissed as a group.

Additionally, because some comments reflect a more technical analysis of the proposed regulations, the summaries for those comments were not summarized as a group. Comments for pages 2497-2587, 2588-2613, 2614-2730, and 2799-2815, which contain a more extensive technical analysis of the proposed regulations have been organized and summarized by comment volume number. The technical comments for Volume 7 are attached to the end of this summary and response.

Comment:

- **The interim rates do not account for the cost of automation because automation is not as complete in smaller counties.**
- **Automation will not result in a reduction in fees.**

Pages reflecting this comment:
2731, 2738, 2739, 2756, 2771-2773

Response
See Response to Common Comment T.18 and X.10.

Comment:
The regulations do not account for increased responsibilities of companies to comply with rules and regulations for lenders, the department of real estate, tax reporting, hazard reporting, IRS reporting, privacy laws, sexual harassment training requirements and other newer obligations.

Pages reflecting this comment:
2731, 2738, 2739, 2746, 2756, 2771-2773, 2787-2788**,** 2789-2790

Response
See Response to Common Comment E.12.

Comment:
The regulations do not distinguish between title insurers and underwritten title companies.

Pages reflecting this comment:
2731, 2738, 2739, 2771-2773

Response
The Commissioner rejects this comment. The regulations recognize that title insurers and underwritten title companies may divide fees or charges for work and services actually performed. (See Ins. Code section 12412.) The regulations do not attempt to assign particular duties to title insurers or underwritten title companies, rather, the regulations cover the entire charge for title services, whether denominated premium or otherwise.

Comment:

- **The cost of implementing the reporting requirements will be prohibitive for many underwritten title companies.**
- **The statistical plan reporting requirements are arduous and could put companies out of business.**

Pages reflecting this comment:
2731, 2738, 2739, 2768-2769, 2771-2773

Response
See Response to Common Comment T.7, X.1.

Comment:

- **A preliminary title report is not a stand-alone product that is used in a transaction.**
- **The regulations do not account for work that is performed on transactions that are not completed and for which no compensation is received.**

Pages reflecting this comment:
2731, 2738, 2739, 2771-2773

Response
The Commissioner rejects this comment. The preliminary report is, indeed, a transaction that the company is generally required to charge for pursuant to Insurance Code section 12404.1. Insurance Code section 12404.1 expressly provides: "The furnishing of a preliminary report by any title insurer, controlled escrow company or underwritten title company, without charge to any person, shall constitute a violation of Section 12404." While section 12404.1 goes on to

allow companies to waive the fee for a preliminary report under specified circumstances, it is clear that this is a voluntary waiver by the company and not an entitlement.

The commenter concedes that the non-collection is a waiver, which reflects its wholly voluntary nature. The Commissioner rejects the suggestion that the market is well-served by parties to the real estate transaction not having to pay for services they order. If parties know they will have to pay for those services, they will order them only when the service is warranted. Thus, the proposed regulations are based not on the assumption that UTCs collect for every preliminary report they issue but that they should not be subsidized by consumers for waiving fees to which they are legally entitled.

Comment:

Title and escrow practices vary between northern California and southern California and rates are higher in southern California. The independent escrow companies do escrows in a different manner which increases their costs and fees.

Pages reflecting this comment:

2731, 2738, 2739, 2771-2773

Response

See Response to Common Comment C.8

Comment:

There is price competition in escrow services and/or title industry. Buyers and sellers are always seeking the lowest price.

Pages reflecting this comment:

2746, 2787-2788, 2789-2790

Response

The Commissioner rejects this comment. Commenter has offered no evidence to support the claim that there is, or will be, price-competition in the escrow and/or title market. On the contrary, the Commissioner has, based on the evidence, found that there is not a reasonable degree of competition.

Comment:

- **The commenter has been a sales representative in the title insurance industry for 21 years. She does not "buy" business.**
- **It is ludicrous to think that title companies conduct business with kickbacks and illegal activity.**

Pages reflecting this comment:

2750, 2789-2790

Response

The Commissioner rejects this comment. The commenter has provided no evidentiary support for this claim and no valid basis for rejecting the substantial evidence on which the Competition Report is based.

Comment:
The regulations will be especially hard on companies that do not have an out of state base. Escrow companies will go out of business if the regulations are adopted.

Pages reflecting this comment:
2750

Response
The Commissioner rejects this comment. The commenter has provided no evidence that costs for providing escrow services vary significantly by region. The commenter does not appear to be claiming they do, but rather that multi-region escrows are able to use profits in one state to subsidize losses or lower profits in other states. Doing so would appear to be illegal unfair discrimination – with or without the proposed regulations. The proposed regulations permit rates that cover the reasonable cost of providing title insurance and a reasonable profit. That remains possible for the regional and the multi-region company alike.

Comment:
Real estate markets are cyclical and reserves have to be built up during active markets to survive slow markets.

Pages reflecting this comment:
2768-2769

Response
See Response to Common Comment E.25

Comment:
The company's fees have not changed since 1997. A fee rollback would create serious financial hardship and could prevent the company from being profitable. The company's underwriter rolled back its fees by 20% in 2006 and the market is currently leveling off and experiencing a downturn in prices.

Pages reflecting this comment:
2731, 2738, 2739, 2771-2773

Response:
See Response to Common Comment E.18, T.8

Comment:

The regulations do not recognize the functions and services provided by escrow officers, including clearing title and making sure that liens and judgments are paid.

Pages reflecting this comment:
2733, 2734, 2735, 2741, 2742, 2743

Response:
See Response to Common Comment E.16.

Comment:
California Title Insurance and Escrow rates are already fair and competitive because of the:

- Escrow Officers' Hard Work
- Customer Service Provided
- Cost of Doing Business

Pages reflecting this comment:
2737, 2745

Response:
See Response to Common Comments: C.1, C.2, C.28, E.3, E.18, E.25, T.2, T.5, T.8, T.18, T.23, X.6, X.7, and X.9.

Comment:
These Regulations will negatively impact the nonprofit community (by limiting volunteer involvement from title and escrow industry):

Pages reflecting this comment:
2731, 2738, 2739, 2771-2773

Response:
See Responses to Common Comments E.25 and T.23.

The regulations determine allowable costs and charges on the basis of industry-representative data. The discounts/relativities appearing in the regulations were derived from a comparison of relativities filed by companies. Furthermore, relativities are expected to be on-balance – that their collective effect should be neutral on revenues. So to the extent that a company uses a higher relativity for, say, a specific endorsement, it will be using a lower relativity for some other endorsement. The differences should have little or no effect on total revenues.

It should be remembered, no company is required to employ the regulatory relativities, nor is any company prohibited from employing different relativities. The relativities are merely inputs to the calculation of the regulatory maxima.

The regulations will not prevent title insurers or escrow entities from providing discounts to non-profit groups. The purpose of the regulations is simply to prohibit excessive rates.

See also Response to Common Comment T.2.

Comment:
Reducing title and escrow fees will eliminate jobs/increase unemployment and reduce competition in the market.

Pages reflecting this comment:
2731, 2738, 2739, 2733, 2734, 2735, 2738, 2739, 2741, 2742, 2743, 2750, 2755, 2756, 2766-2767, 2768-2769, 2770, 2771-2773, 2774-2775, 2779-2780, 2783-2784, 2787-2788, 2791-2793, 2828-2896

Response:
See Response to Common Comments C.30, E.25, T.13 and X.9.

Comment:

- **Reducing fees will result in lower quality of service and delays to homebuyers and sellers/not in the best interest of the consumer because: will increase costs of buying and selling/take longer for loans to close**
- **Fewer Choices for customers closing escrow transactions**
- **Reducing escrow fees will result in less money to accomplish escrow tasks**

Pages reflecting this comment:
2732, 2740, 2747, 2750, 2751, 2774-2775

Response:
See Response to Common Comments C.1, C.3, E.13, E.15, E.29, T.5, X.8 and X.12.

Comment:
Regulations will have a devastating effect on regional escrow companies, underwriters and independent title agents.

Pages reflecting this comment:
2731, 2738, 2739, 2768-2769, 2771-2773

Response:
The Commissioner rejects this comment. The proposed regulations have been amended to provide for regional variations in escrow markets. While the Commissioner expects that each company's rates will be selected by the company with consideration of the conditions of the local markets in which it operates, the Commissioner has found that the proposed regulations properly calculate the maximum rate for escrow, taking regional variations into account.

See also Response to Common Comments C.9, T.7, T.18 and X.1.

Comment:
The escrow business no longer involves simple transactions with each party performing its own functions. They now take on the duties that other entities used to handle and this takes extra time and results in additional liability.

Pages reflecting this comment:
2748, 2759, 2766-2767, 2779-2780, 2783-2784, 2789-2790, 2828-2896

Response:
See Response to Common Comment E.12 and E.28.

Comment:
- **Regulations will have a devastating impact on the title and escrow industries including ability of independent escrow companies to compete:**
- **The regulations are punitive to escrow companies that are under the jurisdiction of the Department of Corporations.**

Pages reflecting this comment:
2791-2793

Response:
See Response to Common Comment E.1 and E.27.

Comment:
- **The regulations will hurt the real estate market.**
- **The regulations will result in State revenue loss due to Notaries' failure to renew their commissions.**
- **Notaries Public will be put out of work/regulations will reduce the number of available Notaries Public.**
- **The regulations will cut costs for those signing loan documents but Notary Public signing agents are still liable for errors and omissions.**
- **Transactions will be more susceptible to fraud, and will increase the number of falsified real property transactions (because regulations will result in fewer Notaries Public).**
- **Regulations will deter others from pursuing the noble career as a Notary Public.**
- **Detrimental impact on Notary Public income causing hardship/Notaries Public deserve to be fairly compensated.**
- **The proposed regulations will restrict Notaries Public from providing the mobile service that allows them to service at home for those who are:**
  -Working

-Older
-Homebound

- **The proposed regulations will compel title insurance and escrow officers to stop using Notaries Public and instead use in-house services. This would have a detrimental effect on consumers/reduce the number of available Notaries.**
- **California does not need regulatory intervention in the free market for notary fees.**
- **The regulations will have a negative effect on Notaries Public and the public/will affect quality of Notary Public service/will create inconvenience to the consumer.**
- **Proposal to cut escrow fees is arbitrary and harmful because Notaries Public provide a critical public service/are an important tool in California's economy.**

Pages reflecting this comment:
2732, 2736, 2740, 2744, 2747, 2751, 2752, 2753, 2758, 2760-2761, 2762-2764, 2765, 2776-2777, 2778, 2781-2782, 2785-2786, 2796-2798

Response:
See Response to Common Comment N.1.

Comment:
The business is owned or operated by and will reduce the salaries of the:

- **Primary Breadwinner**
- **Woman**
- **Single mom**
- **Elderly**

Pages reflecting this comment:
2731, 2737, 2738, 2739, 2745, 2746, 2757, 2771-2773, 2787-2788, 2789-2790

Response:
See Response to Common Comment E.14.

Comment:
Proposed regulations will not alleviate lack of competition in the industry/regulations are counterproductive.

Pages reflecting this comment:
2749, 2774-2775

Response:
See Response to Common Comment C.30, T.1 and X.1.

Comment:

- **If we want to protect the consumer, then instead of regulations the Dept. should find a way to enforce RESPA on both sides of the industry.**

- **The provisions of RESPA are commonly violated. While this is true for both title insurers and escrow companies, it is particularly true for controlled escrow companies. The proposed regulations will result in more controlled escrow companies in Southern California.**

Pages reflecting this comment:
2796-2798

Response:
To the extent that this comment recommends that the Commissioner regulate entities involved in the real estate transaction that are outside of his regulatory authority, the Commissioner rejects this comment. The Department will continue to work with other enforcement agencies to coordinate the most effective approach to combating other fees that violate the Real Estate Settlement Practices Act.

Comment:
- **Escrow Fees are the lowest of all the expenses/most cost effective part of the real estate transaction.**
- **Escrow Fees have not changed significantly (or have been reduced) in the last 34 years.**
- **My company's escrow rates are the lowest in the state.**

Pages reflecting this comment:
2746, 2768-2769, 2789-2790, 2791-2793

Response:
See Response to Common Comment E.9, E.18 and E.26.

To the extent that these comments suggest that the commenter's rates are the lowest in the state, if true, it means that this company will likely flourish under the permanent rate regulatory formula, which will continue to allow this company to compete at lower prices than the industry average. Moreover, to the extent that this company has reduced rates since 2000, the company will be given credit for those reductions in the interim rate reduction formula.

Comment:
Commenter is generally opposed to the regulations or opposes the reduction of fees by 27%.

Pages reflecting this comment:
2733, 2734, 2735, 2737, 2741, 2742, 2743, 2745, 2754, 2755, 2757, 2757, 2758, 2770, 2789-2790, 2796-2798

Response:

The Commissioner rejects this comment. The commenter offers no evidence to support the claim that qualified companies providing good service will not be able to operate successfully under the regulations. To the contrary, the regulations require that charges will be permitted to be high enough to recover reasonable charges plus a reasonable profit. At the same time, the proposed regulations will permit the Commissioner to effectively ensure that title insurance and escrow charges will not be excessive. The Commissioner rejects the claim that no qualified businesses will be able to function under these conditions.

Comment:

- **The Commissioner should focus on title fees.**
- **The Commissioner should focus on junk fees of title and escrow companies.**

Pages reflecting this comment:
2791-2793

Response:
The Commissioner rejects this comment. Except to the extent that the fees of title and escrow companies fall within the definition of "miscellaneous charges" as set forth in Insurance Code section 12340.7, the proposed regulations do restrict title fees and so-called "junk fees." The regulations are intended, in general, to yield sufficient revenue to give the company the opportunity to cover its reasonable costs and to earn a fair profit. Costs are generally recognized on the basis of industry-average costs, which clearly provide that opportunity.
Where a company cannot cover its existing payroll or support its current spending on that basis, it suggests that the company may be over-staffed or insufficiently cost-conscious in its expenditures.

The notable departure from industry-average costs is in the area of sales, and it may well be that companies will not be able to support existing costs compensating sales personnel under the current regulation. However, the regulations are premised on the finding of a lack of competition, the presence of reverse-competition, and the effect of reverse-competition of driving up sales and "customer-service" costs. Denying companies the ability to pass such costs through to consumers is purposeful and appropriate.

Comment:
Commissioner should not punish the industry for the illegal rebating conduct of a few.

Pages reflecting this comment:
2731, 2738, 2739, 2771-2773, 2778, 2791-2793

Response:
The Commissioner rejects this comment. Commenter has offered no evidence that particular companies will be relatively disadvantaged by the proposed regulations. It is not the purpose or effect of the regulations to give to, or take away from, companies any advantage they might have in a competitive market.

Comment:
Escrow work is performed in other states by attorneys and escrow agents in California are comparatively very cost effective.

Pages reflecting this comment:
2746

Response
See Response to Common Comment E.9 and X.15.

Comment:
The proposed regulations will negatively impact small business.

Pages reflecting this comment:
2731, 2738, 2739, 2757, 2771-2773, 2778

Response
See Response to Common Comment T.7, T.18 and X.1.

Comment:

- **Consumers should have a choice regarding service and competitive pricing.**
- **The regulations are a restraint of trade and will limit competition in the industry.**

Pages reflecting this comment:
2732, 2740, 2751, 2766-2767, 2779-2780, 2783-2784, 2816-2817, 2818-2819, 2820-2821, 2822-2823, 2824-2825, 2826-2827, 2828-2896.

Response
See Response to Common Comments A.15, C.30, N.1 and T.1.

Comment:

- **Lender /broker/realtor fees should be targeted.**
- **The focus should be on the kickbacks given to the real estate agents and the mortgage brokers and title insurers.**
- **The Commissioner should establish a roadmap of permissible activities and pursue those that violate the Insurance Code.**

Pages reflecting this comment:
2755, 2771-2773, 2778, 2787-2788, 2785-2786, 2789-2790, 2791-2793

Response

The Commissioner's statutory authority does not include the power to require banks and financial institutions to pay for title insurance. Similarly, the Commissioner lacks the power to regulate the fees charged by brokers or realtors.

See also Response to Common Comment E.8, T.9, and X.17.

TITLE 10. INVESTMENTS
CHAPTER 5. INSURANCE COMMISSIONER
Article 7.1
TITLE INSURANCE STATISTICAL PLAN
AND RELATED RULES GOVERNING RATES AND CHARGES

Summary and Response to Technical Comments Received During
45-day Comment Period

Volume 7, Comment No. 2497-2587:

Commentator: Lawrence E. Green on behalf of the California Land Title Association
Date of Comment: Received 8/29/06
Type of Comment: Written

Summary of Comment (page 1-3):

This passage summarizes the commenter's interest in these proceedings and the nature of the organization that the commenter is affiliated with. This passage also represents a summary of the commenter's specific remarks, which are set forth in greater detail within the subsequent pages of the comment.

Response to Comment:

This portion of the comment is not specifically directed at the Commissioner's proposed regulations or to the procedures followed in proposing the regulations, or simply summarizes comments which are summarized and responded to in more detail below. No response is, therefore, necessary. (Gov. Code section 11346.9.)

Summary of Comment (page 3-11):

This portion of the comment sets forth the commenter's view of the relevant background and laws applicable to title insurance. The commenter also describes other instances in which the Commissioner has taken the position that a rate package is not subject to Office of Administrative Law review. Based on the belief that the proposed regulations set rates and that the rate-setting requirements are intertwined with the statistical plan reporting requirements, the commenter states that the regulations should either be withdrawn or should be reviewed by the Office of Administrative Law.

Response to Comment:

This section of the comment provides a general description of the background and history of Title Insurance law, as well as a summary of arguments that are set forth in more detail in the body of the comment. In this respect, the comment is not specifically directed at the Commissioner's proposed regulations or to the procedures followed in proposing the regulations, or simply summarizes comments which are summarized and responded to in more detail below. Therefore, no additional response is necessary here.

The Commissioner rejects the balance of this comment. The proposed regulations do not fix or determine rates. They define the level above which the rate is excessive. Companies are free to compete by charging any rate they wish so long as the rate is not "excessive." (Ins. Code § 12401.3.) It has long been understood that the code authorizes the Commissioner to prohibit excessive rates and that doing so does not constitute the proscribed fixing or determination of rates. The words "fix or determine" describe regulatory regimes where the regulator specifies the rate that must be charged, as is done is several states. The proposed regulations specify a maximum and permit companies to charge any rate that does not exceed the maximum. That preserves both "competitive rating" and, to the extent it otherwise exists, a "free market." The regulations merely limit competition within the range of rates that are not excessive.

The Commissioner does not claim the proposed regulations to be exempt from OAL review.

Summary of Comment (page 11--12):

Any claim by the Commissioner that the proposed regulations are exempt from review by the Office of Administrative Law ignores the clear prohibition in Insurance Code section 12401 which prevents the Commissioner from fixing or determining a rate level by classification or otherwise. Even if the proposed regulations could be construed to satisfy the ratemaking exception to the Administrative Procedure Act, the proposed regulations violate Insurance Code 12401 because the regulations establish rates.

Response to Comment:

The Commissioner rejects this comment. The Department has prepared the appropriate rulemaking materials and intends to submit the rulemaking file to the Office of Administrative Law for review, and for this reason, the comment is misplaced.

Insofar as the commenter contends that the proposed regulations violate Insurance Code section 12401, see Response to Common Comment 1.3.

Summary of Comment (page 12 & 36)

By requiring rate rollbacks that are effective March 1, 2007, the proposed regulations are beyond the Commissioner's authority. While the Commissioner may have authority to order rate rollbacks pursuant to Proposition 103, those laws are not applicable to title insurance and there is no statute that gives the Commissioner such authority here.

Response to Comment

The Commissioner rejects this comment. To the extent that this comment suggests that the Commissioner is relying upon Proposition 103 as authority for the proposed regulations, see Response to Common Comment 1.2.

Insofar as the commenter states that the Commissioner does not have the authority to order rates to be reduced to lower levels for the title insurance industry, the Commissioner disagrees with the comment. The Commissioner's power to declare rates to be excessive is expressly authorized by Insurance Code section 12401.3. The interim rate reductions represent the Commissioner's determination that rates for title insurance and escrow services have far outstripped the costs of providing those services. The Commissioner has observed that rates for title insurance and escrow services are calculated as a function of the purchase price of the home. Home prices have increased sharply between 2000 and 2005, while the cost of providing those title and escrow services has not.

While title and escrow service providers are entitled to some amount of revenue increase due to factors such as inflation and the increase in the cost of losses for a home that has appreciated in value, the interim-rate reductions limit the amount of rate increases that are permissible in order to prevent the charging of excessive rates. Unlike Proposition 103, which simply declared that rates must be reduced by 20% across the board for multiple lines of insurance without any evaluation of the costs or risks attendant to those rates, the proposed interim-rate reductions were developed only after a careful and thorough investigation of the justification for those rates for title insurance products. As is reflected in the staff reports that are included within the rulemaking file, the increases in real estate values were not in lockstep with the slower increase in the costs of providing the insurance or escrow product.

Summary of Comment (page 12-13)

Senate Bill 1293, as introduced in the Legislature, contained a prior-approval form of rate regulation for title insurance rates. The bill was subsequently amended to remove the Commissioner's approval authority, and to declare that nothing in the law was intended to give the Commissioner power to fix and determine a rate level by classification or otherwise. This legislative history supports the contention that the proposed regulations interfere with California's open competition rating law by setting maximum rates and by ordering rate rollbacks.

Response to Comment

The Commissioner rejects the commenter's argument. The proposed regulations do not purport to require prior approval of rates. What the proposed regulations do, among other things, is implement the Commissioner's authority to prohibit excessive rates as set forth in Insurance Code section 12401.3. The proposed regulations do not amount to a prior approval system for the review of rates. Entities conducting the business of title insurance remain free to file and use rates. If those rates are excessive, however, the Commissioner is authorized to pursue all

available investigative and enforcement remedies to stop and penalize an insurer for the use of rates which are excessive. The fact that the Legislature saw fit to permit insurers to file and use their rates without first receiving the approval of the Commissioner does not remove the Commissioner's authority to prohibit the use of such rates, once it has been determined that they are excessive.

Summary of Comment (page 14-17):

The Commissioner's exclusive procedure for correcting an excessive rate is a quasi-adjudicative process conducted pursuant to Articles 6.7 and 6.9 of Chapter 1, Part 6, Division 2 of the Insurance Code. *Quelimane Co. Inc. v. Stewart Title Guaranty Co.* (1998) 19 Cal.4th 26, 44 concluded that the provisions of Insurance Code sections 12414.26 and 12414.29 apply to the subject of rate regulation. Therefore, the Commissioner's exclusive means by which he may regulate rates is through the quasi-adjudicative procedures set forth in Articles 5.5 and 5.7 of the Insurance Code. In short, title insurance rate regulation cannot be established through the rulemaking process. Because the proposed regulations attempt to regulate rates through rulemaking, the regulations violate the necessity, authority and consistency standards of Government Code section 12342.2.

Response to Comment:

The Commissioner rejects this comment. The proposed regulations are wholly consistent with articles 6.7 and 6.9. No rate will be held excessive before there is a company-specific hearing on its rates and an individualized determination that they are excessive. However, as Insurance Code section 12401.5 contemplates, that determination will be informed by the regulations and by the results of the statistical plan.

Summary of Comment (page 17- 19):

Any attempt to regulate escrow rates and rates for preliminary reports would subject the entities that charge such rates to potential anti-trust lawsuits on the grounds of price fixing. While some of the products and services of title companies are protected from anti-trust lawsuits by the McCarran Ferguson Act, other entities are not so protected. Moreover, it is unclear that title and escrow companies would be protected under the exemption for state action because the proposed regulations are contrary to the policy articulated in Insurance Code section 12401: that title rates should be set by open competition. Thus, the proposed regulations violate the Government Code standards for necessity, authority and consistency.

Response to Comment:

The Commissioner rejects this comment. The regulations are authorized by Insurance Code section 12401. The Commissioner having found that there is an absence of a reasonable degree of competition, the regulations are authorized and companies' compliance with them does not violate the antitrust laws. The commenter has failed to demonstrate how the proposed regulations lack necessity, authority, or consistency.

Summary of Comment (page 19-21):

The Competition Report served as a pretext for the Commissioner's ultimate goal: the regulation of title rates. By deciding to set rates, only after a pre-determined need for a finding of a lack of reasonable competition, the Commissioner's proposed regulations do not meet the necessity standard set forth in Government Code section 11349(a).

Response to Comment:

The Commissioner rejects this comment. The finding of an absence of a reasonable degree of competition is validly based on careful study of the markets and is entirely consistent with similar studies by other authorities. The Commissioner has found the proposed regulations to be necessary to make feasible the discharge of the Commissioner's duty to prevent the charging of excessive rates in the absence of a reasonable degree of competition.

Summary of Comment (page 19-22):

The reports of the following expert economists and actuaries, which were ignored when presented at the January 2006 workshop, serve to discredit the Competition Report. These expert reports demonstrate that the Commissioner's finding of a lack of competition is not supported and that the Commissioner therefore lacks the authority to declare title or escrow rates to be excessive. The expert reports relied upon by the commenter are as follows:

- "An Economic Analysis of the December 2005 Bernie (sic) Birnbaum Report to the California Insurance Commissioner" by Gregory S. Vistnes, Ph.D., Dated January 5, 2006;
- Statement of Michael J. Miller, FCAS, MAAA, on behalf of the California Land Title Association, dated January 5, 2006;
- "Incorrect Conclusions about Competition in the California Title and Escrow Markets Asserted in the December 2005 Contractor Report to the California Insurance Commissioner" by Nelson R. Lipshutz, dated January 5, 2006;
- "Comments and Objections to the Report of the California Insurance Commissioner; an Analysis of Competition in the California Title Industry and Escrow Industry by Bernie (sic) Birnbaum," dated December 5, 2005 with the attached analysis prepared by Dr. Jerod E. Hazleton, Professor of Finance, Insurance, Real Estate and Law, Univ. of North Texas;
- "Competition in Title Insurance Rates in California" prepared by Bruce E. Stangle, Ph.D. and Bruce A. Strombom, Ph.D., dated January 23, 2006; and
- The testimony of Thomas M. Stevens, CRB, CRS, GRI, the President of the National Association of Realtors, dated April 26, 2006.

Response to Comment:

The Commissioner rejects this comment. The Commissioner's staff carefully considered the comments provided at the January 2006 workshop. The suggestion made by many title insurance industry-sponsored witnesses to the effect that title insurance rates benefit from

competitive pressures is unpersuasive and contrary to the Commissioner's observations, the conclusions of previous studies, as well as the observations found in other states. The Commissioner believes that the reverse competitive pressures which exist in the title insurance market have led to an environment in which consumers are unable to exert influence on the price of the insurance product. This lack of price competition has resulted in rates which are often excessive. The proposed regulations are designed to protect consumers against such excess.

Each of the reports cited above have been summarized and responded to elsewhere within this Final Statement of Reasons. No further response is, therefore, necessary.

Summary of Comment (page 23):

Title insurance and escrow rates are not excessive. According to research conducted on behalf of a major title insurer doing business in California, from 1962 to 2005, the price for a CLTA Standard Coverage Owners policy decreased by more than fifty percent. Similarly, a CLTA Standard Coverage Lender's policy for a refinance transaction declined by approximately seventy-five percent over that same period of time. The Competition report failed to consider these price declines.

Response to Comment:

The Commissioner rejects this comment. To the extent the cited studies have been submitted in this record, they are responded to elsewhere in the file. In general, it is apparent that these studies employ an erroneous and inappropriate definition of "price." They observe that title insurers have not raised the percentage rate applied to each transaction, but that is not a meaningful measure. The sizes of the transactions themselves have risen dramatically, so that the prices the companies charge have risen dramatically with them. It is that amount collected, not the percentage rate, that is relevant to whether the premium or other charge is excessive.

Summary of Comment (page 23-24):

The Competition Report failed to consider other states' rates for comparable products, as an indication of whether California's rates were excessive. In fact, prices in California are among the lowest available in any large state, including states like Florida, Texas and New York, where prices are set under a rigid formula of rate regulation. For this reason, the proposed regulations violate the standards for necessity, authority, consistency and reference.

Response to Comment:

The Commissioner rejects this comment. The comment, again, suffers from the infirmity that it confuses the amount charged with the percentage employed to calculate the premium or other charge. Because transaction sizes are so much higher in California than in many other states, even lower percentage rates can yield higher premiums and other charges. References to states, such as Texas, that use state-made rates are irrelevant. California law and the proposed regulations allow each company to charge its own non-excessive rate.

Summary of Comment (page 24):

The proposed regulations will force companies to charge rates that are inadequate, in violation of Insurance Code sections 12401 and 12401.3. Preliminary assessments of the effect of the proposed regulations suggest that many regulated entities will not be able to adequately cover the cost of providing services if they are forced to charge rates similar to the ones set forth in the proposed regulations.

Response to Comment:

The Commissioner rejects this comment. The proposed regulations provide the opportunity for the recovery in rates of each company's reasonable expenses plus a fair profit. Such rates are not inadequate. To the extent that the commenter may be claiming that companies are incurring unreasonable costs that they cannot recover under the proposed regulations, there is no right to collect in rates amounts that are not reasonably incurred.

Summary of Comment (page 25):

The proposed regulations lack clarity and are inconsistent because they provide that a statistical agent will serve as an advisory organization under section 2355.5 and will be selected, subject to a competitive bidding process. There is no statutory authority for any advisory organization to assess members in order to act as a statistical agent, and in any event it is not necessary to engage in a bidding process for advisory organization because such an organization is funded by its members. In this manner, the proposed regulations violate the standards of clarity, necessity, and authority as well as Government Code section 11342.2.

Response to Comment:

The Commissioner rejects this comment. Statistical agents (such as the American Land Title Association, which serves as a statistical agent in many states) are typically funded by their members pursuant to their organic laws. The Legislature is presumed to have been aware of this industry practice in employing industry terminology. The commenter has not asserted otherwise and has provided no basis for any other position.

The objection to competitive-bidding provisions is a revealing admission of the indifference to costs that pervades this industry. If there are multiple entities capable and willing to perform this function, it is entirely appropriate that the one selected to do so (for whose services consumers will ultimately pay) be the lowest-cost qualified bidder.

The concern that has led the Commissioner to provide also for a statistical adviser is apparent from the funding. The statistical agent performs very important duties under the proposed regulations, with significant implications on rates. The fact that this function is performed by an entity paid for its membership, whose rates are at issue, creates a reasonable concern that the function may not be performed in an unbiased manner. Accordingly, the proposed regulations provide for a separate statistical adviser to counsel the Commissioner on proper execution of the statistical plan. The Commissioner requires no special statutory authority to obtain such

services. The commenter's objections to the qualifications of this adviser are unfounded. As the commenter concedes, anyone who provides "insurance supervisory officials" such as the Commissioner "statistical information and data relating to the business of title insurance" is an advisory organization. That is precisely the function prescribed by the proposed regulations. Contrary to the comment, neither the Commissioner nor the statistical agents will be fixing or determining rates. Since the tasks will be state-prescribed, they will be fully eligible for the state action exemption to antitrust liability.

Summary of Comment (page 25-26):

The second type of advisory organization established by the proposed regulations, called a "statistical advisor," does not meet the statutory definition of an advisory organization. Advisory organizations must either recommend and prepare policy forms, endorsements or procedural manuals, or must collect and furnish to its members or insurance supervisory officials loss and expense statistics or other statistical information. The Statistical advisor does neither of the above, and therefore does not meet the statutory definition of an advisory organization. In this manner, the proposed regulations violate the standards of clarity, necessity, and authority as well as Government Code section 11342.2.

Response to Comment:

The Commissioner rejects this comment. Both the statistical advisor and the statistical agent, in accordance with the proposed regulations, will be charged with the task of receiving statistical information, including expense statistics, from the Commissioner for the purpose of advising the Commissioner regarding the calculations he is required to make in accordance with the proposed regulations. The Insurance Commissioner, as a supervisory official, will rely upon the services of both the statistical agent and statistical advisor in gathering and compiling useful data through the statistical plan, in accordance with Insurance Code section 12401.5(b). In this manner, both the statistical advisor and the statistical agent meet the definition of "advisory organization" as set forth in Insurance Code section 12340.8.

Summary of Comment (page 26):

The proposed regulations' establishment of a "statistical advisor" seems tailor-made for someone like the author of the Competition Report.

Response to Comment:

The Commissioner rejects this comment. As the commenter notes, the position will be selected by competitive bidding. The need for the position is explained above. The entity to be selected is unclear. There has been no effort to provide any position for any specific person or entity.

Summary of Comment (page 26):

The proposed regulations lack clarity regarding who is responsible for paying the statistical advisor. In this manner, the proposed regulations violate the standards of clarity, necessity, and authority as well as Government Code section 11342.2.

Response to Comment:

The Commissioner rejects this comment. The regulations are clear that only the statistical agent will be paid for by the companies. Accordingly the costs of the statistical adviser are the responsibility of the Department of Insurance.

Summary of Comment (page 26):

Insurance code section 11340.8 prohibits an advisory organization from making rates, rating plans or rating systems. Because the statistical advisor and statistical agent are each supposed to implement the rate regulations and the interim-rate reductions, they will act in excess of their permitted jurisdiction, as set forth in Insurance Code section 11340.8. In this manner, the proposed regulations violate the standards of clarity, necessity, and authority as well as Government Code section 11342.2.

Response to Comment:

The Commissioner rejects this comment. It is not accurate to suggest that advisory organizations are charged with the task of "making rates, rating plans or rating systems" pursuant to the proposed regulations. The statistical advisor and statistical agent will provide the Commissioner with useful compilations of data and advice so that the Commissioner can calculate the factors necessary for the rate regulatory formulae. Insurance Code section 12401.5(b) expressly provides that the Commissioner "shall designate one or more advisory organizations to assist in the development of the statistical plan and to further assist in gathering data and making compilations thereof." The ultimate purpose of the statistical plan, as set forth in Insurance Code section 12401.5 is to act "[a]s a further aid to uniform administration of rate regulatory laws of this state." In this regard, the Legislature clearly contemplated that advisory organizations could assist the Commissioner in determining whether a rate is excessive within the meaning of section 12401.3.

The Insurance Commissioner, as a supervisory official, will rely upon the services of both the statistical agent and statistical advisor in gathering and compiling useful data through the statistical plan, in accordance with Insurance Code section 12401.5(b). In this manner, both the statistical advisor and the statistical agent meet the definition of "advisory organization" as set forth in Insurance Code section 12340.8.

Summary of Comment (page 26):

Advisory organizations are comprised of industry members. Because, under the proposed regulations, the statistical advisor and statistical agent are charged with the task of making rates, rating plans or rating systems, the regulations may exacerbate the potential exposure to anti-trust

liability for these entities. In this manner, the proposed regulations violate the standards of clarity, necessity, and authority as well as Government Code section 11342.2.

Response to Comment:

The Commissioner rejects this comment. It is not accurate to suggest that advisory organizations are charged with the task of "making rates, rating plans or rating systems" pursuant to the proposed regulations. The statistical advisor and statistical agent will provide the Commissioner with useful compilations of data. This set of data will then be used by the Commissioner to generate the factors necessary for the rate regulatory formulae. Insurance Code section 12401.5(b) expressly provides that the Commissioner "shall designate one or more advisory organizations to assist in the development of the statistical plan and to further assist in gathering data and making compilations thereof…" The ultimate purpose of the statistical plan, as set forth in Insurance Code section 12401.5 is to act "[a]s a further aid to uniform administration of rate regulatory laws of this state…" In this regard, the Legislature clearly contemplated that advisory organizations could assist the Commissioner in determining whether a rate is excessive within the meaning of section 12401.3 by providing compilations of relevant data.

The Insurance Commissioner, as a supervisory official, will rely upon the services of both the statistical agent and statistical advisor in gathering and compiling useful data through the statistical plan, in accordance with Insurance Code section 12401.5(b). In this manner, both the statistical advisor and the statistical agent meet the definition of "advisory organization" as set forth in Insurance Code section 12340.8.

Summary of Comment (page 27):

The Commissioner has acknowledged that the proposed regulations may have a significant adverse economic impact on title insurers, underwritten title companies and escrow companies, and may also adversely impact the ability of California businesses to compete with businesses in other states. Given these potential consequences, why is the Commissioner proposing to adopt these regulations?

Response to Comment:

The Commissioner rejects this comment. The Commissioner has found an absence of a reasonable degree of competition, creating the opportunity for companies to charge excessive rates. Prohibiting excessive rates will, by definition, have an adverse effect on companies that have previously been able to charge excessive rates, but that is precisely the effect the statute contemplates. All companies – those domiciled in California and elsewhere – will equally be required to comply with the proposed regulations, and no company – California-domiciled or otherwise – is affected in its out-of-state business, so there is no improper effect on California businesses. These regulations are necessary to prevent excessive premiums and charges on California transactions.

Summary of Comment (page 27-35 & 39):

Contrary to the Commissioner's economic impact statement, the Commissioner has not considered proposed alternatives that would lessen any adverse economic impact on business. Each of these alternatives should be considered prior to any regulations, especially in light of the burdensome requirements set forth in the proposed regulations. The commenter then sets forth a number of alternatives that it has discussed with the Department:

A. A web-based compilation of rates for various title services. This would have less impact on underwritten title insurers and title insurers than the proposed regulations and would ensure transparent price comparisons for consumers.

B. Proposing Legislation that would require specific disclosures in the home buying process. At present, there are two primary disclosure requirements under existing practices. The first provides that, when an escrow transaction occurs in which a policy of title insurance will not be issued to the parties to the exchange, a notice shall be provided which recommends that a title policy be obtained. The second provides that a title company can provide information about the availability of various title insurance products and the reasons why one may want such coverage. The commenter believes that the Commissioner should implement the disclosure requirements as an alternative to the proposed regulations.

C. Create a multi-disciplinary task force, among various departments, associations and members of the public, in order to solicit new ways to get consumers more directly involved in making choices on settlement services. Thus, the focus of this alternative proposal would be to improve consumer education regarding title insurance services and products.

D. Prepare a study in accordance with Government Code section 9148 et. seq. to examine the licensing of title professionals who are engaged in reverse competitive behavior and consider legislation for professional licensing requirements to prevent such behavior.

E. Work with the National Association of Insurance Commissioners to develop a uniform method for data collection in lieu of the Commissioner's proposed statistical plan.

F. Relax the standards for entries and acquisitions in the market. This could be accomplished, in part by expediting the review of underwritten title company license applications. At present, the Department's license review process can take as long as 28 months. Companies should be given the flexibility to quickly enter the market, whether by license extensions or through the purchase of existing companies. The Department should also encourage capital to be devoted to the title business for technological and systems innovations by removing barriers to the acquisition of existing companies that want to become part of larger, well-capitalized companies. This could be accomplished, in part, by sponsoring legislation that provides for an alternative to acquisitions much like Insurance Code section 1215(b). Finally, the Department should sponsor legislation on license extensions by an underwritten title

company that will make it easier and less time consuming for a company to expand its license to operate in other counties.

Response to Comment:

The Commissioner rejects this comment. He has carefully considered each of the proffered suggestions and has found them not to provide any reason to forebear from adopting the proposed regulations. None of the proffered suggestions would be likely to remedy the absence of a reasonable degree of competition.

A. The suggested web site would not alleviate the problem. Consumers do not understand the title-insurance product and usually do not even know they are buying it, so it is unrealistic to expect them to avail themselves of a web site to do comparative shopping.

B. The suggestions regarding the CAR disclosures lie beyond the statutory authority of the Insurance Commissioner. More fundamentally, consumers are confronted with a blizzard of paperwork, and there is no reason to believe further disclosures added to the mountain would increase competition in title or escrow markets.

C. The recommendation for a "multi-disciplinary task force" to "solicit ideas" may or may not be a good idea, but it calls for action well beyond the authority of the Insurance Commissioner. And, as the commenter notes, such a recommendation was adopted by the Legislature as a resolution, with no perceptible effect on the market.

D. The recommendation to "prepare a study" of the licensing of "title professionals" who engage in improper conduct. The commenter has provided no reason to believe such a study would materially increase competition in any relevant market. Moreover, the commenter appears to recognize that any findings of the study would have to then be implemented by new legislation, an implicit confirmation that the benefits the commenter claims to see in such a study lie beyond the Commissioner's present statutory authority.

E. The recommendation that the Commissioner work cooperatively with the NAIC on a nationwide statistical plan is rejected. There is no reason to believe a nationwide statistical plan would cover all of the information required by the proposed regulations. There is less need for a nationwide system in title insurance because most of the firms subject to the proposed regulations operate only in California. And, of course, there is no reason to believe that an NAIC statistical plan would provide any additional competition to California title and escrow markets.

F. Although other industry commenters claim there are no barriers to entry in this market, this commenter claims that there are regulatory barriers that the Commissioner should eliminate by expediting and relaxing regulatory requirements for entry. The Commissioner rejects the underlying assumption that the absence of a reasonable degree of competition would be likely to be significant ameliorated by

additional companies. The absence of consumer understanding of the market, the vulnerability of consumers to steering, the pervasiveness of controlled business arrangements, and the other structural and behavioral characteristics of the market chronicled by the Competition Report render it very unlikely easier licensure would have any appreciable effect on competition. And the Commissioner rejects comments to the effect that nothing should be done until new legislation is enacted.

At bottom, all of these recommendations have a consistent theme: wait, do nothing now, try to get others to act, and abide excessive rates until some hoped-for future in which the need for the proposed regulations can be met with measures more to the commenter's liking – or, more likely, until interest in correcting the decades-long anti-competitive conditions once more abates and the companies can go on collecting excessive premiums and charges. Consumers have already waited far too long for relief. The Commissioner rejects this theme and all of its constituent comments.

Summary of Comment (page 33):

The Competition Report fails to mention the regulatory barriers to new and existing title entities attempting to compete for available business in this state. The burdensome licensing requirements in California stand as an impediment to new business.

Response to Comment:

The Commissioner rejects this comment. The commenter has proffered no evidence that relaxed regulatory requirements would lead to new entrants who would have any salutary effect on market conditions. As stated above, the Commissioner has concluded to the contrary.

Summary of Comment (page 33):

The Department created impediments to entry into the market when it arbitrarily increased the minimum net worth required for new entrants into the title industry. The minimum net worth requirements were increased in 2003 by one hundred percent.

Response to Comment:

The Commissioner rejects this comment for the reasons stated above.

Summary of Comment (page 36-37):

The proposed regulations and lack of alternatives considered is of great concern because the market for new and existing home sales is down substantially from a year ago to approximately 30-35% less than the base year of 2000 that is referenced in the Competition Report. Similarly, refinance transactions have declined and are expected to decline further. Mortgage loan application volume has declined 26.3% when compared to a year ago. Purchase mortgages have declined by 22.7% and refinance mortgages have declined by 30.5%. Rising interest rates will have a profound adverse economic impact on the title industry (small to medium sized

businesses in particular) which will compound the adverse effect that the proposed regulations will have by establishing the mandatory reduction in rates.

In the last market downturn from 1993 to 1997, many companies were placed under close watch for financial solvency. Many companies either were forced to close their doors or sell their business because they could not survive on their own.

Response to Comment:

The Commissioner rejects this comment. The proposed regulations take into account rising and falling transaction volume and makes appropriate adjustments to the distribution of fixed costs. The interim rates, which have now been postponed to 2009 under the amended regulations and may never take effect, do not provide for any adjustment – upward or downward – due to falling or rising transaction volume. In fact, sharply rising volume since 2000 provided additional grounds for the interim rates to provide for even larger reductions but did not take that phenomenon into account, so there is no great need to take claimed falling volume into account. While home sales may fall to, or even below, 2000 by 2009, it should be remembered that the base rates in effect in 2000 we also effect in earlier years of even lower volume. And while home sales volume may fall below 2000, there is no reason to expect non-sales transactions, which rose several hundred percent in the last six years, to fall to anything close to 2000 volume.

Thus, the Commissioner finds that the interim rates – in particular after amendment of the proposed regulations to adjust the reductions for possible declines in home prices – do not prevent companies from covering their reasonable expenses and earning a fair return. While there may, at any time, with or without the proposed regulations, be some business failures, there would be failures in a competitive market as well. The Legislature's embrace of competition implies acceptance of a concomitant level of business failures.

Summary of Comment (page 37-39):

The Commissioner's statement that the proposed regulations will have a positive impact because it will save consumers approximately $800 million is not legally adequate and fails to account for the jobs that will be lost in the underwritten title company, title insurer and escrow company businesses. Preliminary estimates suggest that many smaller to medium-sized companies will be put out of business. Homebuilder Toll Brothers' press release indicates that contracts have dropped 45% from July to August of 2006 and the cancellation rate has increased. DataQuick reported that the second quarter of California foreclosure activity rose at the fastest pace in 14 years and the chief economist at National City Corporation's study concludes that 39% of the single-family home market is extremely overvalued. All of this demonstrates that the proposed regulations will have a negative impact on jobs, given the current state of the real estate economy. Thus, the Commissioner has not adequately complied with Government Code sections 11346.3 and 11346.5.

Response to Comment:

The Commissioner rejects this comment. The Commissioner stands by his finding that the saving of hundreds of millions of dollars in excessive premiums and charges will have a favorable net effect on the California economy, notwithstanding possible elimination of economically unjustified costs and positions in the title industry. Industry pundits have been issuing dire forecasts and predictions, including assertions of an overpriced market, throughout the sharp rise in prices. If any of these predictions actually materialize, the amended proposed regulations will provide for a correspondingly smaller reduction in rates.

Summary of Comment (page 39-40):

The Commissioner's Notice of Proposed Action and Notice of Public Hearing states that "insurance companies, financial institutions, sub dividers, developers, and services where the gross annual receipts for the business exceed $2 million dollars" do not meet the definition of "small business." This list leaves out underwritten title companies, 15 of which are members of the commenter's organization and have gross revenue of less than $2 million. These small companies do not have the level of automation found in metropolitan areas or the capital to invest in the technology, software and training that would be required by the proposed regulations. While the Department's staff report recognizes the geographic differences in escrow rates and real estate price appreciation, the regulations do not make adjustments for these geographic differences.

Response to Comment:

The Commissioner rejects this comment. The proposed regulations have been amended to delay the requirements of the statistical plan for small independent UTCs until services and software are commercially available that will enable those companies to comply with the statistical plan economically. The proposed regulations have also been amended to provide for regional variations in escrow charges.

Summary of Comment (page 40-41):

The Department's Conservation and Liquidation Office recently stated that it needed to increase its reconveyance fee to $200 in order to continue to provide reconveyances on behalf of conserved title companies. This fee increase was 344% higher than the conclusively-presumed $45 fee that is set forth in Civil Code section 2941. Thus, the Conservation and Liquidation Office of the Department acknowledges that title companies can become insolvent and that a service cannot be priced below the cost of providing the service. The proposed regulations' one-size fits all approach will have a devastating impact on some companies. Thus, the regulations do not comply with Government Code sections 11346.3 and 11346.5.

Response to Comment:

The Commissioner rejects this comment. To the extent the commenter claims the statutory fee referred to is itself inadequate, the Commissioner rejects the comment on the ground that he does not have authority to alter the statute. To the extent the commenter is proffering the experience

of insolvent companies as the standard by which to assess reasonable rates, the Commissioner rejects the comment as unpersuasive and unreasonable.

Summary of Comment (page 41-42):

The Commenter summarizes the preceding comments: The Commissioner lacks authority to set title rates or require an industry-wide rate rollback. The proposed regulations also violate federal anti-trust law. Additionally, because companies will be driven out of the market by the unprofitable rate system, the regulations will have an anti-competitive impact. The burdensome, extensive statistical reporting and record keeping requirements will drain capital from productive ventures such as profitability, expansion and job creation. The regulations' analysis of impact upon California businesses is considerably inadequate. The regulations should be withdrawn, so that the Commissioner can work with a wider sector of groups to find alternatives that will benefit consumers without crippling the title industry.

Response to Comment:

The Commissioner rejects this comment for the reasons stated above in addressing each of the summarized points.

SUMMARY AND RESPONSE TO COMMENT ATTACHMENTS

The commenter has attached comments from Gregory S. Vistnes, Michael J. Miller, Nelson R. Lipshutz, Jerold E. Hazelton, Bruce E. Stangle and Bruce A. Strombaum, and Thomas M. Stevens. The Commissioner responds to each of these comments separately in this file.

Volume 7, Comment Bates Pages 2539-2557:

Commentator: Gregory Vistnes on behalf of the California Land Title Association
Date of Comment: Received 1/5/06
Type of Comment: Written

All comments contained in this report are responded to when they are cited in other comments or reports, the comments are restated in later reports of Dr. Vistnes and those reports are responded to, or portions may not be specifically directed at the Commissioner's proposed regulations or to the procedures followed in proposing the regulations and require no response.

Volume 7, Comment Bates Pages 2558-2587:

Commentator: Michael Miller on behalf of the California Land Title Association
Date of Comment: Received 8/29/06
Type of Comment: Written

Commenter: Michael Miller, 2

Summary: The commenter summarizes his background and qualifications.

Response: Because this is not a comment specifically directed at the proposed regulation text, no response is required.

Commenter: Michael Miller, 3

Summary: The commenter defines "actuarially sound rates" and "prospective ratemaking." The commenter says a prospective analysis of costs would be necessary to support the conclusion that title rates are excessive. Birnbaum's report contains no actuarial analysis. Each insurer has its own expectations about future losses and expenses. The determination of excessiveness must be made on an insurer-specific basis. Birnbaum has not done an actuarial analysis of any individual insurer.

Response: The Commissioner rejects this comment. Regulation by formula based on industry-average costs has long been practiced by regulatory agencies and approved by the courts. That includes applying numerical values adopted in regulations to individual companies' hearings without giving those companies the opportunity to adjudicate the values. See, e.g., *20th Century Ins. Co. v. Garamendi* (1994) 8 Cal.4th 216.

Commenter: Michael Miller, 4

Summary: Reduced loss payments do not mean that title insurance is necessarily low-risk. Title claims may develop 25 to 30 years after policy issuance. Title insurers are required to maintain statutory reserves for up to 20 years. Their financial results are highly sensitive to economic cycles. Birnbaum cites financial results from a 5-year period without analyzing whether these results are from up-cycle or down-cycle.

Response: The competition report included data on profitability for a ten-year period from 1995-2004. See also response to common comment C.25.

Commenter: Michael Miller, 4

Summary: Birnbaum cites "ROE" returns of 10.16% to 38.4%. These are really returns on statutory surplus, not equity. Birnbaum didn't determine equity for any title insurer or the industry as a whole. Birnbaum didn't explain why his "ROE returns" are significantly different from the yearly change in statutory surplus. For instance, a 24.69% ROE in 2004, but a statutory surplus increase of only 1.9%.

Response: Statutory surplus is very similar to GAAP return on stockholder equity. Differences may arise from such things as the statutory premium reserves, but these are relatively minor. The four companies shown in the competition report represent the major portion of the title insurance industry, due to the high concentration of market share. Return on statutory surplus may not match change in statutory surplus, for example, when substantial dividends are

upstreamed to the parent holding company. This does not mean, however, that return on statutory surplus is not meaningful or that it does not track GAAP returns reasonably closely.

Commenter: Michael Miller, 5

Summary: Rates are not excessive unless the rates are likely to produce a return that is unreasonably higher than a specific insurer's cost of capital. Birnbaum has not analyzed any title insurer's cost of capital or the range of reasonable returns above the cost of capital.

Response: The Commissioner rejects this comment. Regulation by formula based on industry-average costs has long been practiced by regulatory agencies and approved by the courts. That includes applying numerical values adopted in regulations to individual companies' hearings without giving those companies the opportunity to adjudicate the values. See, e.g., *20th Century Ins. Co. v. Garamendi* (1994) 8 Cal.4th 216.

Commenter: Michael Miller, 6-9

Summary: The commenter provides his curriculum vitae.

Response: Because this is not a comment specifically directed at the proposed regulation text, no response is required.

Volume 7, Comment Bates Pages 2588-2613:

Commentator: J. Robert Hunter, on behalf of the Consumer Federation of America, the California Reinvestment Coalition, Consumer's Union and the National Association of Consumer Advocates
Date of Comment: Received 8/30/06
Type of Comment: Written

This comment was entirely in support of the regulations. No response is, therefore, necessary.

Volume 7, Comment Bates Pages 2614-2730:

Commentator: American Land Title Association (ALTA)
Date of Comment: Dated August 24, 2006, received August 30, 2006
Type of Comment: Written

Summary of Comment (page 1):

The first two paragraphs on page 1 are a preliminary statement.

Response to Comment:

This portion of the comment is not specifically directed at the Commissioner's proposed regulations or to the procedures followed in proposing the regulations, or simply summarizes comments which are summarized and responded to in more detail below. No response is, therefore, necessary. (Gov. Code section 11346.9.)

Summary of Comment (pages 1 - 2):

A summary of the workshop and the work of Nelson Lipshutz on behalf of ALTA is set forth on pp. 1-2. ALTA submitted Dr. Lipshutz's Preliminary Study, *Incorrect Conclusions About Competition in the California Title and Escrow Markets Asserted in the December 2005 Contractor Report to the California Insurance Commissioner* dated January 5, 2006 at the workshop to alert the Commissioner to serious irregularities and errors in the Birnbaum Report. (ALTA's submission at the workshop is attached as Exhibit 1.) ALTA anticipated that the Commissioner would take action to reexamine the Birnbaum Report or undertake a further study. This does not appear to be the case. This refusal by the Commissioner to undertake a proper study of the competition in the California title and escrow markets raises questions as to the motives of the Commissioner and undermines the foundation and authority for the Proposed Regulations.

Response to Comment:

The Commissioner rejects this comment. The Commissioner has considered Dr. Lipshutz's comments and responds to them separately in this file. He has found the comments not to be well-founded. The commenter's aspersions on the Commissioner's motives are rejected.

Summary of Comment (page 2):

ALTA submits two studies prepared by Dr. Lipshutz: *Incorrect Conclusions About Competition in the California Title and Escrow Markets Asserted in the December 2005 Contractor Report to the California Insurance Commissioner* dated August 30. 2006 (Exhibit 2) and *Some Practical Issues Raised by the Title Insurance Statistical Plan and Related Rules Governing Rates and Charges Proposed by the California Insurance Commissioner* dated August 30, 2006 (Exhibit 3) and Dr. Lipshutz will provide oral testimony on behalf of ALTA at the hearing.

Response to Comment:

The Commissioner rejects this comment. The Commissioner responds separately to Exhibits 2 and 3 and to ALTA's comments at the hearing separately in this file.

Summary of Comment (page 2):

The Commissioner does not have authority to adopt the Proposed Regulations. A regulator cannot adopt a regulation that is in conflict with applicable statutes or that is not necessary. *See* Gov't Code Section 11342.2; 2 Cal.Jur.3d (Rev'd) Part1A, Administrative Law, Section 244; *Terhune v. Superior Court*, 65 Cal.App.4th 864, 872.

Insurance Code Section 12401 provides that "[i]t is the express intent of this article to permit and encourage competition between persons and entities engaged in the business of title insurance on a sound financial basis, and *nothing in this article is intended to give the commissioner the power to fix and determine a rate level by classification or otherwise*." (Emphasis in the comment.) Under California law, rates should neither be excessive, inadequate or unfairly discriminatory. Insurance Code Section 12401.3(a). The Commissioner is charged with the responsibility of determining whether a rate is excessive, inadequate or unfairly discriminatory under the procedure specified by the California legislature. See Insurance Code Sections 12414.26 and 12414.29.

The Proposed Regulations, which constitute rate regulation, appear to be in direct conflict with the Rate Filing and Regulation provisions of the Insurance Code. Insurance Code Section 12401.

Response to Comment:

The Commissioner rejects this comment. The proposed regulations fall squarely within his rulemaking authority and are the necessary, practical way in which he can enforce the prohibition against excessive rates. The Legislature did not intend, by encouraging competition, to encourage the charging of excessive rates.

Summary of Comment (page 3) :

The Commissioner relies on the flawed and erroneous Birnbaum Report, believing that the Birnbaum Report justifies him in finding that all rates are excessive unless they comply with the maximum rates he seeks to mandate in the Proposed Regulations. He apparently believes that a finding of inadequate competition can be used to justify rate regulation contrary to the direction of the Legislature. This assertion of quasi-legislative authority in the face of direct statutes to the contrary is unsupportable because it is premised on an erroneous and discredited study. As demonstrated by Dr. Lipshutz, the alleged justification is a "sky hook"; there is competition in the California title insurance and escrow markets.

Response to Comment:

The Commissioner rejects this comment. The Commissioner responds to the comments of Dr. Lipshutz separately in this file, rejecting his conclusion that there is a reasonable degree of competition. It is not true that the Commissioner believes the absence of a reasonable degree of competition justifies contradicting the legislation; rather, he believes that legislation requires that a finding of the absence of a reasonable degree of competition requires his enforcement of the prohibition against excessive rates.

Summary of Comment (page 3) :

It does not appear the Commissioner has made the required finding that any rate, or all rates, is excessive. The adoption process for the Proposed Regulations fails to conform with the applicable procedures. *See* Insurance Code Sections 12414.26 and 12414.29. Moreover, the Commissioner has failed to apply the relevant legal standards or made the findings required by

the Legislature. Insurance Code Section 12401(a), 12401.3(a). There has been no finding that all title and escrow rates are unreasonably high in all markets under all circumstances.

Response to Comment:

The Commissioner rejects this comment. The commenter misconstrues the applicable statutes. The finding that a specific rate is excessive is made in a hearing on that rate and is a finding that can be made without finding that all rates are excessive. The commenter has cited no authority, and none exists, for the assumption that the Commissioner may not adopt regulations to facilitate the identification of excessive rates without a prior finding that all rates are unreasonably high. The references to Insurance Code sections 12414.26 and 12414.19 are irrelevant and inexplicable; the former concerns "prosecution or civil proceedings under any other law of this state," and the latter concerns judicial review. Likewise, the reference to the absence of findings is incorrect insofar as it refers to the competition finding, which is, in fact, made in section 2355.6 of the proposed regulations, or to the excessiveness of any rate, which would be made in a company-specific hearing.

Summary of Comment (page 4):

The Commissioner should defer proceeding with a proposed regulation to allow careful consideration of matters presented at public hearing. Similarly, on request, the hearing should be continued to allow interested parties to comment on matters, including new issues. See Government Code Section 11346.8(e) (if a new issue concerning a proposed regulation is raised at hearing and a member of the public requests additional time to respond to the new issue before the state agency takes action, it is the intent of the Legislature that rulemaking agencies consider granting the request for additional time if, under the circumstances, granting the request is practical and does not unduly delay action on the regulation).

ALTA raises three new matters relative to the Proposed Regulations which have not been considered by the Commissioner, whether: 1) the Proposed Regulations violate constitutional rights; 2) the Legislature prohibits the Commissioner's actions (seeking to regulate independent escrow companies); and 3) the Commissioner has not complied with the direction of the Legislature as set forth in Insurance Code Section 12401.5(b).

Response to Comment:

The Commissioner rejects this comment. See Response to Common Comment X.20.

Summary of Comment (pages 4-5):

The Proposed Regulations implicate at least two Constitutional concerns, due process protections owed to property owners when the state deprives them of property (Cal Const., art. 1 Section 7,15; U.S. Const., 14th Amend., Section 1) and the "takings" clause which guarantees property owners "just compensation" when property is "taken for public use" (Cal Const., art.1, section 19, U.S. Const., 5th Amend.). *See Kavanau v. Santa Monica Rent Control Board*, 16 Cal.4th 761 at 770-771 (1997) (due process protection focuses on the government's means and purpose:

whether the government's method rationally furthers legitimate ends. The takings protection focuses on the impact of the government's action: whether the government has in effect appropriated private property for its own use, rather than merely regulating a private use of property. This conceptual distinction blurs somewhat in cases applying the due process and takings clauses to price regulations, including rent control. In that context, courts sometimes employ overlapping terminology and standards, treating the two clauses as a single constitutional protection of private property rights.)

Response to Comment:

The Commissioner rejects this comment. See Response to Common Comment A.14.

Summary of Comment (pages 5-6):

The Proposed Regulations violate Due Process. Case law holds that to withstand Constitutional scrutiny, a rate regulation must conform with the policy of the State. *See Nebbia v. New York*, 291 U.S. 502 at 537 (1934) (the requirements of due process are satisfied where the laws passed are seen to have a reasonable relation to proper legislative purpose and are neither arbitrary nor discriminatory. Price control is unconstitutional if arbitrary, discriminatory or demonstrably irrelevant to the policy the legislature is free to adopt); *Permian Basis Area Rate Cases*, 390 U.S. 747 at 769-770 (1968) (same holding re price control). Other cases are string cited, but not paraphrased or quoted. In this case, the California Legislature has determined that title insurance rates and escrow rates are to be governed by the marketplace. Insurance Code Section 12401. Accordingly, the Proposed Regulations are contrary to the policy enacted by the California Legislature relative to title insurance and, if applicable, escrow rates.

The Commissioner cites *20th Century Ins. Co.*, as authority for the Proposed Regulations. But this case does not obviate the Constitutional concerns because *20th Century* addresses a regulation adopted pursuant to Proposition 103.

Response to Comment:

The Commissioner rejects this comment. The proposed regulations conform to the policy of California to prohibit excessive rates. By defining the threshold of excessive rates, the regulations clearly bear a reasonable relationship to that objective. It does so by carefully measuring the reasonable costs of providing the service and a reasonable return on capital, which is not arbitrary but rather is the classical requirement for rate-regulation. The statement that the Legislature has said rates are to be governed by the marketplace simply ignores the fact that where, as here, the Commissioner finds the absence of a reasonable degree of competition, he or she is authorized to prohibit the use of excessive rates. The commenter's string citations do not support the commenter's claim, and the commenter has failed to explain why it believes they do. The reference to *20th Century* is inapposite, if for no other reason because the commenter is advancing the case for a constitutional point, rendering the statutory basis of the regulations irrelevant.

Summary of Comment (pages 6-7):

The Proposed Regulations contain other elements that may violate Due Process. A significant issue exists as to whether the Proposed Regulations will enable companies to maintain financial integrity, attract necessary capital and fairly compensate investors. *See Permian Basin*, 390 U.S. at 792; *Kavanau*, 16 Cal.4th at 772. The Legislature has expressly identified the importance of ensuring the financial solvency of title companies through its adoption of the mono-line provision of Insurance Code Section 12360 and specialized capital and reserve requirements. Unlike other lines of Insurance, including those affected by Proposition 103, the enactment of these provisions underscore the Legislative policy that title companies are to be treated differently and provided with sufficient rates of return, taking into account appropriate economic cycles, to ensure their economic solvency at all times, including during times of depression. *See* Lipshutz, *The Role of the Monoline Requirement in Assuring Title Insurance Effectiveness* (December 2004) (Exhibit 4).

The Proposed Regulations will have a significant impact on companies. *See* Exhibit 3; *see also Clouds on Horizon After Title Industry's Bright Year*, Special Report, A.M. Best, October 2006 at pp. 6-11 (Exhibit 5). This issue, which requires expert testimony from both State and industry experts has not received proper consideration. *Kavanau*, 16 Cal.4th at 771; *Power Comm'n v. Hope Gas Co.*, 320 U.S. 602 (1944).

A significant issue exists as to whether the Proposed Regulations violate due process because they set a maximum rate that is not subject to variance depending on the respective insurer. In evaluating the constitutionality of Proposition 103, the existence of an adequate method for obtaining individualized relief was an important consideration in the analysis. *See Calfarm Ins. Co.*, 48 Cal.3d 825.

Response to Comment:

The Commissioner rejects this comment. The proposed regulations set the maximum rate at a level explicitly sufficient to cover the reasonable costs of providing the service plus a reasonable profit. The commenter offers no reason to doubt that at that level companies can maintain the financial integrity and attract capital. To the extent that a given company cannot, there is no constitutional right for the company to charge excessive rates. (See, e.g., *20th Century Ins. Co. v. Garamendi* (1994) 8 Cal.4th 216, 294 and cases cited.) The Commissioner does not understand the monoline restriction for title insurance to imply any lesser concern about the financial integrity of other insurance lines, such as those governed by the regulations at issue in *20th Century*, but rather an accommodation to the structure and function of the title insurance business. The regulations contain provisions to allow higher rates in downturns in the real estate market, such as, for example, the spreading of fixed costs over fewer transactions.

It is not clear what "expert testimony" the commenter believes is missing from this record. The regulations have benefited from the expertise of the Department of Insurance and from thousands of pages of comments by experts and lay commenters, all of which have been considered by the Commissioner.

The comment's reference to *Calfarm Ins. Co. v. Deukmejian* (1989) 48 Cal.3d 805 is inapposite. There the Supreme Court was confronted with an across-the-board rate-reduction of 20% without reference to the cost of providing the insurance. In that case, the Court held, "[t]he risk that the rate set by the statute is confiscatory as to some insurers from its inception is high enough to require an adequate method for obtaining individualized relief." (48 Cal.3d at p. 820.) The same cannot be said of a rate that is based on meticulous calculation of industry-average cost data and properly determined values for normative standards.

Summary of Comment (page 7):

The Proposed Regulations constitute a taking. The California Supreme Court has recognized that a due process violation with respect to rate regulation constitutes a taking. *See Kavanau*, 16 Cal.4th at 781-782 ("[t]he similarity of this takings standard to the due process requirement that a regulation 'have a reasonable relation to a proper legislative purpose (citation) supports Kavanau's argument that a due process violation in this context constitutes a taking.") Accordingly, it appears the Proposed Regulation constitutes an unconstitutional taking based on this authority alone.

Response to Comment:

The Commissioner rejects this comment. There can be no question that the proposed regulations have a reasonable relation to the legislative purpose of avoiding excessive rates when a reasonable degree of competition is absent. They identify the threshold of excessive rates, thereby making it easier for the Commissioner – and, significantly, regulated companies – to identify what constitutes an excessive rate. Indeed, the Commissioner has found that there is no practical alternative to such a regulatory approach. The large number of regulated firms, the variety of products and services, and the difficulty in determining what constitutes an "unreasonably high [rate] for the insurance or other service provided" (Ins. Code, § 12401.3, subd. (a)), makes such regulations essential to make the task manageable. The fact that *Kavanau* cites, at precisely the pages to which the commenter points, *20th Century* and *Duquesne Light Co. v. Barasch* (1989) 488 U.S. 299, on which *20th Century* relies, confirms that the same principles applied by the Supreme Court in *20th Century* apply here. (See *Kavanau*, 16 Cal.4th at 781-782.)

Summary of Comment (pages 7-8):

The Proposed Regulation falls squarely within several factors indicating that, if adopted, the Proposed Regulations may constitute an unconstitutional taking. The non-comprehensive list includes:

- The economic impact of the regulation on the claimant;
- The extent to which the regulation has interfered with distinct investment-backed expectations;
- The character of the governmental action;
- Whether the regulation interferes with interests that are sufficiently bound up with the reasonable expectations of the claimant;
- Whether the regulation affects the existing or traditional use of the property;

- The nature of the State's interest in the regulation and, particularly, whether the regulation is reasonably necessary to effectuate a public purpose;
- Whether the regulation provides the property owner benefits or rights that mitigate the financial burden imposed; and
- Whether the regulations extinguishes a fundamental attribute of ownership.

Other than the discredited Birnbaum Report, nothing in the record demonstrates consideration, through expert studies and reports, of any of these factors. Accordingly, there is an insufficient record relative to these factors.

Response to Comment:

The Commissioner rejects this comment. The general considerations to which the commenter alludes are properly weighed in the proposed regulations that have been carefully tailored to conform to the constitutional principles outlined in the leading cases on insurance rate-regulation to which the Commissioner has cited.

Summary of Comment (page 8):

It does not appear the Commissioner considered whether the effect of the Proposed Regulations would be to create rates that are inadequate. ALTA is not aware that such information has been requested. *See Calfarm Ins. Co.*, 48 Cal.3d at 822-823, reaffirmed in *20th Century*, 8 Cal.4th at 245 (a confiscatory rate is necessarily an inadequate rate.) Insurance Code Section 10401.3 (*sic.* 12401.3?) sets forth the standards applicable to this determination. This determination should be made given the importance the Legislature placed on the financial solvency of title insurers.

Response to Comment:

The Commissioner rejects this comment. See Response to Common Comment X.4.

Summary of Comment (pages 8-10):

The Proposed Regulations violate the jurisdiction of other regulators. The California escrow market is wide and diverse and participants include: title insurers, underwritten title companies, controlled escrow companies, escrow companies, realtors, lenders, attorneys and others. The California Legislature has divided the regulation of the escrow industry among several regulators: the Commissioner of Corporations, the Insurance Commissioner, the Real Estate Commissioner, the State Bar of California and the Finance Director.

Escrow companies are regulated by the California Department of Corporations and the Corporations Commissioner. Financial Code Sections 17000, *et seq.* (the "Escrow Law.") However, even this scheme fails to provide the Corporations Commissioner the power to set escrow rates and charges. Accordingly, the policy of California, as determined by the Legislature and consistent with Insurance Code Section 12401, is to let the market control escrow rates and charges.

The California Legislature has determined that the Insurance Commissioner is to have no regulatory power or authority over escrow companies or any escrow agent that are subject to the Financial Code. When the Legislature enacted the Escrow Law, it expressly exempted title insurers and underwritten title companies from the Escrow Law. *See* Financial Code Section 17006(a). When the Legislature created exemptions for certain market segments, it provided for that exempted market segment to be regulated by a separate and distinct regulator. *See* Financial Code Section 17006(c); *Escrow Institute of California v. Pierno*, 24 Cal.App.3d 62, 366 (1972). In each instance, the Legislature elected to let escrow rates and charges by determined by the market and not by regulation.

The Proposed Regulations will, if adopted, permit the Commissioner to do indirectly what he is expressly prohibited from doing – regulating all players in the escrow market by artificially imposing caps for escrow rates and charges at significantly lower-than-market levels. This issue has not been considered.

Another issue that remains unconsidered is the artificial distortion of market escrow rates by the Proposed Regulations and the interference with the Legislature's election to let escrow rates and charges be determined by the market.

Response to Comment:

The Commissioner rejects this comment. The proposed regulations are explicitly limited to companies within the Commissioner's jurisdiction. The extent to which other officials who have some regulatory authority over such companies may lack the authority to prohibit their use of excessive rates is irrelevant the Commissioner's express authority to do so. To the extent the Commissioner's exercise of his indisputable authority over controlled escrow companies may have indirect effects on companies outside his jurisdiction, the Legislature is presumed to have contemplated such effects and found them not to militate in favor of withholding authority from the Commissioner.

The Commissioner also doubts the commenter's assumption that a lowering of charges by controlled escrow companies will affect demand for the services of other escrow companies. The Commissioner has found that there is an absence of price-competition in the escrow market, which implies that the so-called independent escrow companies will not have to reduce their own prices to meet competition. However, to the extent that such companies charge more than a reasonable amount for their services, if the effect of the proposed regulations is to lower the cost to consumers from such unreasonable charges, that is a salutary effect not to be avoided.

Summary of Comment (page 10):

Anti-trust issues may also arise out of the Proposed Regulations. As the market artificially adjusts to the Proposed Regulations, other members of the escrow industry may be subject to potential anti-trust liability for conforming their rates and charges to those imposed by the Proposed Regulations.

Response to Comment:

The Commissioner rejects this comment. See Response to Common Comment A.15.

Summary of Comment (pages 10-11):

The Statistical Plan does not conform to Insurance Code Section 12401.5. Section 12401.5 provides that a statistical plan must be "reasonably adapted to each of the rating systems in use within the state" and should be considered in conjunction with statistical plans used elsewhere in the country. As explained by Dr. Lipshutz, the Statistical Plan included in the Proposed Regulations is excessive and burdensome and does not conform to any other state statistical plan.

Further, Dr. Lipshutz has identified "serious security problems" associated with the proposed Statistical Plan which have not been addressed by the Commissioner. See Exhibit 3 at pp. 1-2.

Response to Comment:

The Commissioner rejects this comment. The Commissioner has separately responded to the comments of Dr. Lipshutz. See also Response to Common Comment A.12.

Summary of Comment (page 11):

The Commissioner has unilaterally embarked on a cumbersome and unnecessary statistical plan that will impede the uniformity the Legislature desires. Ironically, the National Association of Insurance Commissioners is undertaking amendment of the Market Regulation Handbook to develop a standardized data call or uniform statistical plan for title insurance. Fifteen states are participating in the Working Group, although California is not. ALTA is assisting. The Working Group is considering incorporation into its data call elements of the ALTA Claims Codes and the ALTA Guidelines for Using ALTA Claims Codes (Exhibit 6). The Chair of the Working Group anticipates completing work in early September which will then be proposed for adoption by the Market Regulation and Consumer Affairs Committee and, then, the NAIC.

ALTA requests that the Commissioner continue the hearing on the Proposed Regulations until after the adoption of the standardized data call by the NAIC and thereafter, modify the Proposed Regulation to create uniformity with the NAIC data call.

Response to Comment:

The Commissioner rejects this comment. The scope and detail of the statistical plan is reasonably related and necessary to the objective of providing the Commissioner data sufficient to serve as an aid in determining whether rates are excessive. The Commissioner is aware of the NAIC Working Group and has considered the contents of chapter 18 of the Market Regulation Handbook. The document is being developed for a wholly different purpose than rate-regulation, namely department examination of companies. Its contents would be wholly inadequate to the purposes of the statistical plan specified in Insurance Code section 12401.5.

Summary of Comment (Bates pages 2627- 2730):

An Executive Summary is at Bates page 2628; a report entitled *Incorrect Conclusions About Competition in the California Title and Escrow Markets Asserted in the December 2005 Contractor Report to the California Insurance Commissioner* by Dr. Nelson Lipshutz (January 5, 2006) is at Bates pages 2629-2646;

Statement to California Insurance Commissioner John Garamendi is at Bates page 2647; a report entitled *Incorrect Conclusions About Competition in the California Title and Escrow Markets Asserted in the December 2005 Contractor Report to the California Insurance Commissioner* by Dr. Nelson Lipshutz (August 30, 2006) is at Bates pages 2648-2667.

Executive Summary, no page #: The commenter provides an executive summary of his comments.

Response: Responses to the comments summarized in the executive summary are provided below, so no response to the summary of comments is needed.

Summary of Comment, Page 1: The commenter describes the nature of his engagement by the American Land Title Association.

Response: This portion of the comment is not specifically directed at the Commissioner's proposed regulations or to the procedures followed in proposing the regulations. No response is, therefore, necessary. (Gov. Code section 11346.9.)

Summary of Comment, Page 1-2: The Birnbaum Report incorrectly asserts that reverse competition is a unique feature of title insurance rather than a standard type of marketing to distributors used by many industries.

Response: The Commissioner rejects this comment. Reverse competition is a well-established concept in insurance economics and has been used to describe the market structure of title insurance and credit insurance markets for at least 30 years. The term has been used, in reference to title insurance, for nearly 30 years, apparently first having been coined by the 1977 Department of Justice study. Since then, it was repeated in several other studies, including the Peat Marwick report for HUD and the California Insurance Commissioner's Bulletin 80-12. The term has been codified in regulations, including the New York State credit insurance regulation and has been used and defined in work products of the National Association of Insurance Commissioners. In addition, the comment mischaracterizes reverse competition. Reverse competition does not refer generally to marketing to distributors nor to consumers seeking advice of third parties; it refers to a market structure in which the seller markets the product to a third party who refers the paying customer to the seller, the consequence of which is that the referrer of the business has the market power and is able to extract considerations from the seller who passes the cost of the considerations onto the paying consumer who has no market power to discipline the pricing of the seller.

Summary of Comments, Page 2-3: Title companies do market extensively to consumers through their websites on the internet. But title and escrow companies have found that direct advertising

to the public is of limited efficacy. Lenders' advertise low closing costs to consumers directly and it is becoming less frequent for lender's title insurance costs to be passed through to borrowers as new loans originate on a no closing cost basis. In such cases, the lender is strongly motivated to shop for the best price because it can recover its costs only through interest rates.

Response: The Commissioner rejects this comment. The existence of title insurance company and underwritten title company web sites does not equate to direct marketing to the consumers who pay for the products and services. Rather, the web sites are directed at the "customers" of the title insurers, underwritten title companies and escrow providers – where "customers" are understood to be participants in the real estate process other than the paying consumer. The fact that direct marketing to consumers is of limited efficacy is a function of the structure of title insurance markets, the nature of the product and the nature of the purchase. Such inefficacy, however, does not justify the unreasonable marketing expenses by title insurers and underwritten title companies to secure the referrals of business. In theory, lenders who do not pass along the cost of title insurance as a separate charge to consumers should have an incentive to seek the lowest title insurance rates from title insurers. The commenter has provided no evidence, however, that this market dynamic is actually occurring or that lenders are pushing for lower rates from title insurers. Lenders would retain an interest in higher title insurance rates if the quid pro quo was free services and other considerations – the types of considerations found in illegal kickbacks and other free services today.

Summary of Comment, Page 3-4: The Birnbaum Report misinterprets the behavior of California title insurance prices as evidence for the absence of price competition. The actual range of prices found in the market is greater than those included in the Birnbaum Report, particularly for escrow. In a highly competitive market, prices charged will be close together. The Report's review of base rates and single refinance plan fails to capture the price competition found in special discounts.

Response: The commenter mischaracterizes the Birnbaum Report conclusion about base rate changes over time. The Birnbaum Report analyzed rate filings and rate changes over time and found not only little diversity among insurers in price, but virtually no change over time. In fact, the changes that did occur were rate increases for companies after a merger to make the acquired company's prices equal to the acquiring company's prices. The absence of price competition was evidenced not by a narrow range of prices among insurers at a particular point in time, but by the absence of change over time and the absence of any company to use a price change as a method for gaining more market share. There is no evidence to support the claim that various discount programs have had a meaningful impact on prices in California. The Commissioner's review of rate filings made by title insurers, including requests for information to filing companies for impact analyses of various discounts, contradicts the claims of the commenter. Filing companies are typically unable to identify the number of consumers receiving a particular discount. More important, filing companies misrepresent the overall rate impact of filings. In one instance, a Fidelity company made a filing in late 2006 claiming the filing represented an overall reduction of over 20%. In fact, the filing resulted in an overall rate increase of about 1% to 2%. The companies included in the price comparison in the Birnbaum Report account for the vast majority of market in California. Other, smaller companies either serve a niche or captive market associated with affiliated business arrangements or otherwise have little impact on the

overall outcome of the market. Most important, there is no evidence to indicate that any insurer has used lower prices to gain market share.

Summary of Comments, Page 6-7: The Birnbaum Report incorrectly characterizes barriers to entry. Established business relationships are generally not a barrier to entry.

Response: The evidence indicates that established business relationships with entities in the position to refer title and escrow business are a barrier to entry. Such evidence includes the fact that virtually every underwritten title entry in the past six years has been an affiliated business arrangement with an entity with established business relationships. Other evidence includes the prevalence of expensive "recruitment" of key title and escrow personnel from competitors who bring large blocks of business when they switch companies.

Summary of Comment, Pages 7-8. Entry and exit form the escrow and title business has been extensive. Data from the Department of Corporations on independent escrow companies show 90 entries in 2004 and 1001 in 2005. Exit is also easy and plentiful.

Response: The Commissioner rejects this comment. The data provided by the commenter provides no information about substantive entry in the market, understood as a new competitor adding supply capacity that previously did not exist. The Commissioner's review of independent escrow company licensing activity shows that the largest independent escrow companies – those with the greatest number of branches and the most escrow volume – are affiliated with title insurance companies or underwritten title companies. Further, the review found that many new companies were simply established escrow officers leaving another company to open their own business, indicating that the profitability of escrow exceeded the inefficiencies of establishing a one-person company. Further, the presence of independent escrow companies is almost entirely limited to six Southern California counties and, consequently, does not affect the escrow markets in the remaining 52 counties. Further, the presence of hundreds of independent escrow companies has not produced any price competition as the prices in the six counties where hundreds of independent escrow companies operate are twice the prices in northern California counties with no independent escrow companies and fewer than dozens of escrow providers.

Summary of Comment, Page 9-11. New underwritten title companies have entered the market and existing underwritten title companies have expanded to other counties, indicating ample entry.

Response: The Commissioner rejects this comment. The commenter's analysis is incorrect because it fails to recognize that the new underwritten title companies were uniformly affiliated business arrangements that added no new capacity to the system. The analysis of expansion to other counties is also incorrect because it fails to account for the retirement of an affiliated underwritten title company in a county where a new license has been granted to the expanding underwritten title company. In this case, there is no real entry and no new capacity, but only a rationalization of operations by the parent. The analysis of expansion is also incorrect because it fails to account for independent companies leaving the market due to acquisition and, consequently, fewer entities in the market. Moreover, the commenter has failed to provide any evidence that the claimed entries provided any new source of price-competition.

Summary of Comment, Page 11: The Birnbaum Report places undue emphasis on concentration in the market. High concentration itself is not an indicator of lack of competition. Concentration is better measured by underwritten title company and independent escrow company market share.

Response: The Commissioner rejects this comment. The Birnbaum Report used the HHI as only one indicator of competition and market structure, among several others. Consequently, the claim that undue emphasis was placed on the measure is a mischaracterization of the Report. However, the Report found very high HHI values, indicating a very concentrated market. While high market concentration alone does not indicate a lack of price competition, the absence of price competition is much more likely in a market with a few companies controlling the market than in a market with many players with small market share. The market shares of title insurance companies are clearly the appropriate measures of market concentration for title insurance. The market share of distributors of the product is not the appropriate measure, in the same way that the market shares for auto insurance are appropriately calculated by the market shares of auto insurance companies as opposed to market shares for auto insurance agents.

Summary of Comment: The Birnbaum Report incorrectly asserts that the title insurance industry is earning excessive profits without any consideration of the level of profits that appropriate for the industry. Rates of return for the Dow Jones, S&P 500 and selected consumer product companies and consumer service industries were higher than those for title insurers and underwritten title companies.

Response: The Commissioner rejects this comment. First, the comment is factually incorrect. The profitability cited – return on equity – for underwritten title companies and title insurers was generally greater than returns available from an investment in the S&P 500. The fact that there may be other industries experiencing even higher returns on equity does not refute the fact that UTC profits are excessive and super-competitive. Moreover, the comparison is inappropriate because the proper measure of comparison is not what other industries have earned, but what the reasonable rate of return was an industry subject to rate regulation. During the period studied, the reasonable after-tax rate of return that would have been used in establishing reasonable rates for title insurance would have been in the range of 10% to 12% – far less than the returns earned by title insurers and underwritten title companies and, consequently, indicating excess profitability of title insurers and underwritten title companies. In addition, the reported profitability of title insurers and underwritten title companies greatly understates the profitability of the title and escrow industry for several reasons. First, many owners of underwritten title companies take profit as salary, bonus or commission, which reduces the stated profitability by turning profit into an expense. Second, there are many affiliate transactions among underwritten title companies, title insurance companies and other affiliates, some of which result in double-counting of expenses, some of which reflect profit reported as an expense, such as a management fee, and some of which are inflated expenses for services provided. Third, and most important, profitability, understood as the difference between revenue and the reasonable cost of providing a service is greatly understated because title insurers and underwritten title companies spend the bulk of what would otherwise be profit on expenditures that benefit the referrers of title and escrow business. This "profit" is spent on illegal kickbacks as well as legal expenditures that

provide no benefit to the consumer paying for the product, but greatly benefit the real estate agents, mortgage brokers, lenders and homebuilders who are in the position to refer business to title insurance companies and underwritten title companies. The evidence of such expenditures is found in the captive reinsurance schemes under which title insurance companies rebated almost half of the title insurance premium to homebuilders and in the very large percentage of personnel costs devoted to sales, marketing and consumer support, where consumer support is the industry term used to describe free services to those entities considered "customers" by title insurance companies and underwritten title companies – namely, real estate agents, mortgage brokers, lenders and homebuilders.

Summary of Comment, Page 13: The Birnbaum Report incorrectly asserts that the lack of immediate rate response to changes in costs in indicative of a lack of competition. The industry is highly cyclical and title insurers adjust their rates to compensate for secular trends in long-run marginal cost to generate an adequate profit on average over the real estate cycle. During the 1980-1990 period the title industry had a return on equity which averaged 6%, less than the return on risk-free Treasury bonds.

Response: The Commissioner rejects this comment. The Commissioner rejects this comment. The industry profitability for the 1980s is inapplicable for several reasons. First, investors do not look to returns from twenty years ago to judge the profitability of an industry today. Recent profitability is clearly a better indication of the prospects for an industry. Second, the results of the 1980s were skewed by unique events related to the Savings & Loan scandals, including devastated real estate markets in many states and historically unprecedented losses resulting from S&L fraud. Third, the premise behind is the comment is flawed and unreasonable. The premise is that title insurers and investors are willing to accept low profitability in some years because it will even out with high profitability in other years, somehow averaging out over a real estate cycle. This is illogical because title insurers and investors have no idea how long a real estate cycle will take or how high or deep the cycle will go. It is empirically incorrect because title insurance companies do not explain low profitability as a planned event for which they will recover with high profitability a few years down the road. Rather, the national title insurance groups are publicly-traded companies who, like other publicly-traded companies, must deliver profitable results quarter after quarter. There is no evidence to support the claim that title insurers have a long-term horizon when determining rates in California.

Summary of Comment, Page 15: The Birnbaum Report presents no analysis of cost trends, but relies on an article from A.M. Best. Automation does not necessarily result in lower costs.

Response: The Commissioner rejects this comment. The Commissioner rejects this comment. In a competitive market, only those technological advances that reduce cost will ordinarily be purchased. There is no reason to doubt that the technology being purchased in this industry is lowering the cost of providing the product. Title search is a good example. No one can reasonably deny that the widespread replacement of hand-searching of titles with computer-searching of digital records has greatly reduced the cost of providing title insurance. The fact that these cost savings have not been accompanied by commensurate price-reductions confirms the absence of price-competition and the need for regulation. Further, the study cited by the Birnbaum Report was prepared by the American Land Title Association – the trade association

of title insurance companies – and the A.M. Best Company – an organization that analyzes and rates the solvency and investment potential of insurance companies. It is reasonable to rely upon the conclusions in this study about lower operating costs due to automation, perfection of title and greater volume.

Summary of Comment, Pages 15-16: The Birnbaum Report does not acknowledge that the monoline requirement for title insurance companies is an important consumer protection.

Response: The Commissioner rejects this comment. The fact that a monoline requirement is a barrier to entry does not conflict or contradict the requirement's role as a consumer protection. Even if the commenter's argument about the benefits of the monoline requirement is accepted, it does not negate the fact that the requirement is a barrier to entry.

A report entitled *Some Practical Issues Raised by the Title Insurance Statistical Plan and Related Rules Governing Rates and Charges Proposed by the California Insurance Commissioner* by Dr. Nelson Lipshutz (August 30, 2006) at Bates pages 2668-2674).

Summary of Comments, Page 1: The commenter describes his engagement by the American Land Title Association and his qualifications.

Response: This portion of the comment is not specifically directed at the Commissioner's proposed regulations or to the procedures followed in proposing the regulations. No response is, therefore, necessary. (Gov. Code section 11346.9.)

Summary of Comments, Page 1-2: Unit statistical plans are appropriate for some property casualty lines because the rating is complex and, therefore, no easier to establish an aggregated data collection system than a system collecting data on each policy. In contrast, title insurance rating manuals contain relatively few rates, so unit statistical data is unnecessary and not cost-beneficial. Collecting such detailed data raises security problems.

Response: The Commissioner rejects this comment. The assumption behind the comment is incorrect. Title rating manuals are as lengthy and complex, if not more complex, than those found in workers' compensation or private passenger auto insurance. Further, the cost to a reporting company is not greatly affected by reporting aggregated or detailed data, but is affected by the information collected. Once a company collects a certain attribute about policies, there is little, if any cost difference, in reporting aggregated vs. individual policy data. In fact, it is likely cheaper to provided the detailed data because no resources are needed to prepare the aggegrated reports. In addition, the unit transaction format has important advantages over summary reporting. Changes – additions, deletions, modifications – to the data reported are easier and cheaper to implement in a unit transaction format because they do not involve rewriting entire software programs to produce the summary reports and do not require modifications to the existing format. The unit transaction provides greater ability to perform data quality review because of the detailed nature of the records that reveal problems masked in summary reporting. The unit transaction format provides greater flexibility and lower costs for obtaining new analyses. With summary reporting, the reporting company is required to develop a new aggregation program. With unit transaction reporting, the statistical agent and the Commissioner

already have the data available for analysis. The collection of unit transaction data raises no security issues that do not otherwise exist for any type of data reporting to the Commissioner. The Department routinely collects and safeguards confidential information and there is no reason to expect that the Department would fail in this instance.

Summary of Comment, Pages 2-3: The expense of the proposed statistical plan will be great compared to the modest expenses for summary reporting. Startup and ongoing costs for the statistical agent would be in the millions of dollars.

Response: The Commissioner rejects this comment. The comparison to the commenter's costs of summary data collection is inapplicable because those summary reports are insufficient to provide the information necessary for effective rate regulation. In other states which collect data to review or promulgate rates, including New Mexico, Florida and Texas, far more information is collected than the summary reports cited by the commenter. Even in those states, which have detailed data collection comparable to the proposed statistical plan, the data are insufficient for rate regulation purposes. The Texas Department of Insurance augmented its detailed data collection program with a special data call in the past two years consisting of hundreds of additional questions and data items. The Florida Office of Insurance Regulation is revising its data collection program to improve its ability to regulate title rates. The Commissioner disagrees with the cost estimates for startup and ongoing operations for a statistical agent to collect data pursuant to the statistical plan and believes the costs will be less than $1 million to start and much less than $1 million a year on an ongoing basis. Moreover, such costs are reasonable in relation to the over $4 billion a year title and escrow industry revenue in California and the projected savings to consumers from rate regulation of at least hundreds of millions of dollars.

Summary of Comment, Page 3: The costs to companies for compliance with the statistical plan will be enormous and require revisions of existing systems.

Response: The Commissioner rejects this comment. The revised regulation eases compliance in several ways. First, it eliminates certain data elements to be collected. Second, it extends the time frame for initial collection and reporting of data by a year, enabling reporting companies to modify systems as part of normal business operations. Third, it provides an exemption for small companies if viable commercial software and services are is not available.

While the introduction of any statistical plan will increase costs to reporting companies from a situation of no reporting, the proposed reporting requirements will prove beneficial to reporting companies and consumers. By institutionalizing reporting requirements and providing a detailed description of the information to be reported on an ongoing basis, the cost to reporting companies will likely be less than the costs of ad hoc special data calls would be. In addition, the statistical plan is necessary to ensure that reporting companies collect the relevant data so it can be reported. Further, the primary goal of the statistical plan and financial reporting requirements is not to reduce costs but to provide the Commissioner with accurate cost information to ensure that prices charged to consumers reasonably reflect the costs associated with providing title insurance products and escrow services. Finally, the Commissioner notes that the proposed regulations will apply to over $4 billion in annual revenues, and the evidence

indicates that excessive charges run well into the hundreds of millions of dollars a year, providing context to the costs of compliance.

In addition, the data to be collected is either already collected by insurers and underwritten title companies, should be collected as part of reasonable business practices or is statutorily required. The Commissioner also notes that Fidelity, First American and Stewart all have affiliates that develop and deploy transaction management software for participants in the real estate business, including title agents, title insurers, real estate agents, lenders and others and that other independent vendors also provide transaction management software, including Hall Settlement Services' eTitleAxis and TSS Software Corporation's Title and Settlement System. The purpose of this software is to track transactions in real time and assist participants in carrying out the transactions by carrying out functions and adding information electronically. Major players in the title and escrow market are already using and deploying systems which capture the data required by the statistical plan. It is unreasonable to expect that these same companies, which can develop and deploy such transaction management software are not in a position to utilize that same type of software to capture basic information about its own title and escrow transactions.

Summary of Comment, Page 4: There are technical problems with the statistical plan. The income statement does not have an expense for increase in IBNR. The transaction report does not cover the simultaneous issue of two owner's policies. There are many fields that require free form answers that cannot be analyzed automatically and will require manual review.

Response: The Commissioner accepts this comment in part and rejects this comment in part. The income statement has been revised to include an expense item for change in loss reserves. The transaction report does provide for reporting of transactions that include two owner's policies; the total premium and total liability will be reported together and not individually. The text fields are used because there are no standard responses for the requested data elements at this time. The text responses will be analyzed and, if appropriate, will be modified in the future to use standard responses. In some instances, a description of a prior entry is requested and a text response is necessary and reasonable.

Summary of Comments, Pages 4-5: The basic rate regulatory principles embodied in the proposed regulations are sound, and parallel those I have advocated myself over the years. Setting profits based on the return on GAAP equity, taking explicit account of investment income, is the core of sound insurance rate-making.

Response: The Commissioner agrees with this comment.

Summary of Comments, Page 5: Establishing the profit target based on experience in other P&C lines will lead to incorrect profitability for title insurers. The proposed rate-making method does not analyze the leverage ratio appropriate for title insurers subject to substantial title plant investment requirements, nor examine the equity risk premium needed by title insurers as opposed to P&C insurers in other lines. For example, the arbitrary 3.75% figure for the equity risk premium is inconsistent with all the standard capital market data available.

Response: The Commissioner rejects this comment. The risk premium has been adjusted, and the adjusted figure is fully explained in the Staff Report on the Profit Factor.

Summary of Comments, Page 5: The rating formulas in the proposed regulation incorporate arbitrary factors (e.g., 10% for sub-escrow employees and 15% for sales costs) which should not be adopted without explicit economic analysis that has withstood critical review. Title insurance is unique not only in its operations but in its marketing requirements, and these unique features need to be analyzed and taken into account before a valid standard can be established.

Response: The Commissioner rejects this comment. The provision for the sales factor is explained and justified in the Staff Report on the Sales Factor. The provision for subescrow personnel costs utilizes an estimate of 10% of the time to perform subescrow as full escrow. This is reasonable based on the activities involved and the commenter has not proffered evidence demonstrating otherwise.

Summary of Comments, Page 5: Small consumers currently pay less than the cost of producing and servicing the title insurance they purchase. Disallowing justification of a higher rate for one category by a lower rate for another category as set forth in the proposed regulation would eliminate the cross-subsidy to low income consumers who purchase inexpensive homes.

Response: The Commissioner rejects this comment. To the extent the commenter argues (without proffering evidentiary support) that companies currently are using high rates to subsidize other rates, the commenter is asserting that the proposed regulations will terminate unfair discrimination in existing practices, which would be an additional reason in favor of adoption of the proposed regulations.

Summary of Comment, Page 6: 2000 was a weak year for the industry. Establishing rates which put insurers into a chronic loss position can only lead to insurer insolvencies or to voluntary exit from the California title insurer market.

Response: The Commissioner finds that the title industry achieved reasonable profitability in 2000 and that it is an appropriate year serve as a basis for the interim rate reduction, if such reduction is implemented, because it was the beginning of a period of rapid home price appreciation. Furthermore, the interim rate reductions are tied to rates filed by the companies in 2000, which presumably were considered adequate by the companies filing and using the rates.

Article entitled *The Role of the Monoline Requirement in Assuring Title Insurance Effectiveness* at Bates pages 2675-2702.

Summary of Comment (bates page 2675-2072):

This document is a paper, written by Dr. Nelson Lipshutz in December of 2004. The paper discusses the importance of the monoline restriction for title insurance, which is a restriction in many states that prohibits title insurers from transacting any other line of insurance in addition to title insurance. The paper discusses the pros and cons for the monoline restriction and concludes that the restriction is still relevant and necessary for title insurance.

Response to Comment:

The Competition Report is a study that the Commissioner is relying upon in proposing the regulations. The Competition Report notes that the monoline restriction is a barrier to entry in California. To the extent that this comment has been offered for the purpose of countering the Competition Report's findings regarding the effect of the monoline restriction, the comment is rejected. Even assuming that the commenter is correct regarding the salutary benefits of the monoline restriction, one unavoidable consequence of that restriction is that it represents a barrier to entry into the California market.

Moreover, because this paper is not a comment specifically directed at the Department's proposed action or to the procedures followed by the Department in proposing or adopting the action, no response is necessary. (Gov. Code section 11346.9(a)(3).)

A.M. Best article entitled *Clouds on Horizon After Title Industry's Bright Year* (October 2005) at Bates page 2703-2722.

To the extent that the commenter referenced this exhibit in support of his comments, the Department's responses to those comments and referenced exhibit is set forth above.

ALTA Risk Codes are at Bates pages 2723-2726; ALTA 2002 Guidelines are at Bates pages 2727-2730.

To the extent that the commenter referenced this exhibit in support of his comments, the Department's responses to those comments and referenced exhibit is set forth above.

Volume 3, Comment No. 1089-1106 (same as Volume 7, Comment Nos. 2799-2815):

Commentator: Jeanne Flynn Martin on behalf of Commerce Title Insurance Company
Date of Comment: Received 8/28/06
Type of Comment: Written

Summary of Comment (page 1-3):

This passage summarizes the commenter's general concerns about the proposed regulations, the commenter's affiliation and general business experience in California as well as the general laws which describe the limitations on an agency's power to promulgate regulations that are necessary and not in conflict with existing law.

Response to Comment:

This portion of the comment is not specifically directed at the Commissioner's proposed regulations or to the procedures followed in proposing the regulations. Additionally, this portion

of the comment reflects summaries of comments that are summarized and responded to in greater detail below. No response is, therefore, necessary. (Gov. Code section 11346.9.)

Summary of Comment (page 3-4):

Insurance Code section 12401 states that the purpose of the title rate regulation statutes is to encourage competition and is not intended to give the Commissioner the power to fix and determine a rate level by classification or otherwise. This prohibition would include a prohibition on setting a maximum rate, as rates are to be determined by the market and not the Commissioner. The Legislature underscored its intent to prohibit the Commissioner from imposing rate caps by providing in the statistical plan provisions that the Commissioner does not have the "power to fix and determine a rate level by classification or otherwise." Because the Commissioner's proposed regulations seek to do exactly that, they conflict with applicable law.

Response to Comment:

The Commissioner rejects this comment. The proposed regulations do not "fix" or "determine" rate levels. They define the level above which the rate is excessive. Companies are free to compete by charging any rate they wish so long as the rate is not "excessive." (Ins. Code § 12401.3.) It has long been understood that the code authorizes the Commissioner to prohibit excessive rates and that doing so does not constitute the proscribed fixing or determination of rates. The commenter is incorrect in asserting that the proscription against fixing or determining rates precludes the Commissioner from finding a rate excessive or from defining the value above which the rate is excessive. The facile assertion that rates are to be determined solely by the market is refuted by the statutory authority of the Commissioner to prevent excessive rates, precisely when he finds that the market is not sufficiently competitive to ensure effective price competition.

Summary of Comment (page 4-5):

Because the regulations conflict with applicable law, the Commissioner's perceived short-term benefits to consumers which would result from reduced title and escrow rates cannot justify or legitimate the proposed regulations. Regulations that are inconsistent with the existing law are void, despite any altruistic motivations for such regulatory proposal.

Response to Comment:

The Commissioner rejects this comment. While it is agreed that regulations that conflict with statutory law are void, no such conflict exists between the proposed regulations and the Insurance Code.

Summary of Comment (page 5-6):

A rate cannot be held excessive under Insurance Code section 12401.3 unless it is (1) unreasonably high for the insurance and (2) there is an absence of a reasonable degree of competition. As section 12401.3 demonstrates, the Legislature did not authorize the

Commissioner to make industry-wide rate determinations or to specify discounts applicable to base rates.

Response to Comment

The Commissioner rejects this comment. The comment correctly summarizes a portion of section 12401.3, but the assertion that this section demonstrates the absence of authority to make industry-wide rate determinations is a non-sequitur. And the proposed regulations do not specify discounts that must be provided, they simply take into account existing (and potential future) industry practices with respect to discounting when calculating the maximum rate. Each company may apply a greater or lesser discount of its choosing, so long as the resulting rate does not exceed the maximum permitted.

Summary of Comment (page 6)

The title and escrow industries provided significant evidence in conjunction with the January 5, 2006 workshop which confirmed that the Competition Report is inaccurate and unreliable. This evidence includes papers written by Mr. Lipshutz, Messers. Stangle and Strombom, Dr. Hazleton, Dr. Vistnes and Mr. Miller. Thus, because the Commissioner's finding of a lack of competition relies upon the findings of the Competition Report, the findings have been discredited and represent an improper means to achieve an illegal end.

Response to Comment

The Commissioner rejects this comment. He has responded to the comments enumerated by the commenter elsewhere in this file. The Commissioner has concluded that the findings of lack of competition are sound and that the proposed regulations are the appropriate legal response to that finding.

Summary of Comment (page 6, footnote 20):

The Commissioner must concede that reverse competition has existed since at least 1977. Despite the fact that thousands of rate filings have been made between 1977 and the present, the Commissioner never found that the market is incapable of promoting competition until now. In fact, a number of title entities who participate in the market and provided comments at the Department's January 5, 2006 workshop agree that the market is characterized by intense competition.

Response to Comment:

The Commissioner rejects this comment. The absence of prior corrective action is no reason not to take such action when the evidence of the need is before him. Furthermore, the failure of companies to lower their rates since 2000, in light of the sharp increase in home prices, has both confirmed the absence of competition and given greater urgency to the need for corrective action.

Summary of Comment (page 7-8):

While rates have increased for other lines of insurance, as confirmed by the studies authored by Messers. Stangle and Strombom, the commenter's company has filed for title rate decreases in connection with homeowners title policies. These rates have been reduced by as much as 20% for some owner's policies. These reductions were made at a time when the costs of doing business have risen, as state and federal laws create new and growing obligations for financial accounting, compliance, fraud prevention and information security. Thus, the Commissioner's finding of a lack of competition cannot be considered credible – particularly when that finding is premised solely on the Competition Report.

Response to Comment:

The Commissioner rejects this comment. He responds to the cited comments of others elsewhere in this file. The commenter has failed to provide evidence of widespread reductions in rates, and the Commissioner has not seen rate-filings evincing any such broad reductions. Small reductions of limited scope do not offer a substantial reason not to adopt the proposed regulations. The rising cost of doing business – and the corresponding sources of lower costs, such as automation – are all captured in the proposed regulations.

Summary of Comment (page 8):

Aside from a short, unsupported statement in the July 3, 2006 Staff Report, the Commissioner has made no finding that any specific rate is unreasonably high for the insurance or other services provided. Because the Commissioner has not made a finding that any rate – or even all rates - are excessive, the proposed regulations are in conflict with Insurance Code section 12401.3

Response to Comment:

The Commissioner rejects this comment. The proposed regulations do not contain a finding of excessiveness of any specific rate; rather, they contain the means by which it may be determined whether a specific rate is excessive. That is fully consistent with all applicable provisions of the Insurance Code.

Summary of Comment (page 8-9):

The Commissioner cannot make a determination as to whether a rate is excessive, inadequate or unfairly discriminatory until he has considered past loss experience within or outside of the state, a reasonable margin for profit both countrywide and within the state, and other judgment factors deemed relevant within and outside of the state. The Competition Report and July 3, 2006 Staff Report demonstrate that the Commissioner has not considered these factors. Because of this clear disregard for the Legislature's direction set forth in Insurance Code section 12401.3, Commissioner lacks authority to adopt these regulations.

Response to Comment:

The Commissioner rejects this comment. While it is true, as the commenter asserts, that a determination that a specific rate is excessive must take into consideration past loss experience within or outside of the state, a reasonable margin for profit both countrywide and within the state, and other judgment factors deemed relevant within and outside of the state, the regulations do precisely that, providing an allowance for loss experience, profit, and other relevant factors. When they are applied to a specific rate, if the application results in a finding of excessiveness, that finding is based in relevant part on those factors.

Summary of Comment (page 9):

Insurance Code section 12401.5 reconfirms that the Commissioner is prohibited from regulating rates in any way. In particular, section 12401.5 confirms that the statistical plan cannot be developed or used for this purpose. The proposed regulations clearly indicate that the statistical plan data will be the basis for the determination of maximum title insurance and escrow rates. Using the statistical plan for this purpose is expressly prohibited under section 12401.5 and therefore the proposed regulations directly conflict with this section.

Response to Comment:

The Commissioner rejects this comment. The commenter has proffered no basis for the comment's conclusion that Insurance Code section 12401.5 may not use the results from the statistical plan to determine maximum rates. On the contrary, section 12401.5 clearly contemplates that the statistical plan and financial data are intended to function as an "aid to uniform administration of rate regulatory laws of this state" and that the information may be used "in reviewing and evaluating individual rate filings by title insurers pursuant to the standards set forth in Section 12401.3."

Summary of Comment (page 10-11):

The Commissioner cannot demonstrate a reasonable necessity for the proposed regulations as required by Government Code section 11342.2. Not only is the Commissioner's finding of an absence of rate competition fallacious, but there is no basis for contending that the existing title market is structurally incapable of promoting rate competition. As the California Land Title Association has noted, there are a number of methods that could be introduced to promote rate competition, including an on-line rate comparison guide similar to the one implemented in Colorado. The Commissioner's refusal to undertake this obvious solution is clearly demonstrative of the unreasonable nature of the proposed regulation.

Response to Comment:

The Commissioner rejects this comment. The comment is explicitly based on denial of the finding of the absence of a reasonable degree of competition, which denial the Commissioner has rejected. The comment is further based on a faulty reading of Insurance Code section 12401.3. A finding that a reasonable degree of competition does not exist leads, under that section, not to authority for the Commissioner to take steps to increase competition but to authority to find rates

excessive. The Commissioner has reasonably determined that the proposed regulations are the appropriate and necessary means to do implement this provision.

Summary of Comment (page 11):

The Commissioner has failed and refused to respond to any of the numerous fatal defects and errors, both analytical and empirical, which were identified within the Competition Report by the title and escrow industries. This also demonstrates the unreasonableness of the proposed regulation.

Response to Comment:

The Commissioner rejects this comment. He has, throughout this file, summarized and responded in detail to all of the relevant comments.

Summary of Comment (page 11-12):

The statistical plan is integral to the proposed regulations. As is set forth in Insurance Code section 12401.5(c) the statistical plan must be adopted in accordance with the provisions of the Government Code. For the reasons discussed above, the proposed regulation conflicts with the applicable title insurance statutes, including the Legislature's instructions that "nothing … is intended to give the commissioner power to fix and determine a rate level by classification or otherwise."

Response to Comment:

This is merely a restatement of earlier arguments which are summarized and responded to above, no further response is, therefore, necessary.

Summary of Comment (page 12-13):

Government Code section 11346.3 requires state agencies to assess the potential for adverse economic impact on California businesses and individuals, including the need to avoid unnecessary or unreasonable regulations or reporting, recordkeeping or compliance requirements. The proposed regulations are a "poster child" of why this statute was adopted. Almost 200 pages of the regulations provide detailed transaction-level reporting requirements and would require the commenter's organization to report a total of 30 statistical reports. Much of the data required by the statistical plan is not currently collected by the commenter's organization and is not supported by any of data collection systems used by the organization. Not only would this data collection require a detailed accounting of individual employee time, but it may also require the reporting of information that is protected from reporting due to federal and state laws governing information privacy.

Response to Comment:

The Commissioner rejects this comment. While the Commissioner recognizes the detail required and the cost associated with reporting, he does not credit the claim that it would be unduly burdensome to comply. Specifically with respect to the transaction-level reporting, each item required to be reported is information that is already keyed into a computer in the course of producing the title and escrow products. This information should not have to be rekeyed. While the commenter's organizations may not currently have written or purchased the programs necessary to extract the information, the Commissioner fully expects that such a capability can be economically obtained, either by in-house programming or use of commercial software. With regard to possible federal or state laws, the commenter has identified no law that would prohibit a regulated company from providing any of the enumerated information to its state regulator.

Summary of Comment (page 13):

Government Code section 11346.3 should be read in harmony with Insurance Code section 12401.5, which encourages the Commissioner to consider statistical plans used by other states in order to develop uniform statistical reporting plans. The commenter is not aware of any evidence that would suggest that the Commissioner made an effort to comply with this requirement. In fact, the data required by the Commissioner's statistical plan appears to require the reporting of data that is not required in any other state.

Response to Comment:

The Commissioner rejects this comment. He is aware of, and has considered, data practices among California companies and in other jurisdictions and has concluded none meets the needs of the proposed regulations. In particular, the Commissioner's decision has been informed by the Department's experience in promulgating two data calls to California title underwriters and underwritten title companies, which produced widespread claims that the companies' existing systems were not adequate to respond to the requests and, when data were reported, produced widespread inadequacies in the data and in the definitions of data elements. Furthermore, the statute the commenter cites merely states that the commissioner *may* consider the specified matters, not that he must do so.

Summary of Comment (page 14-15):

Government Code section 11346.3 requires the Commissioner to assess the potential for adverse economic impact on businesses and individuals, including the impact on business' competition relative to businesses in other states. Thus, the Government Code requires the collection of information from the affected parties prior to submitting the proposed regulations. Although the Commissioner discusses the impact on affected businesses in the Initial Statement of Reasons, there is no empirical data or analysis of how businesses will be affected. Moreover, the statements made are inaccurate, such as the suggestion that the costs of compliance with the statistical plan will be modest in light of the costs already incurred in by title entities in the current collection and reporting requirements. While the commenter has not had sufficient time to fully assess the financial cost of implementation, it is unquestionable that those costs would be substantial. In fact, even the cost of properly reviewing and considering the implementation costs would be substantial, and at present, are incalculable.

Response to Comment:

The Commissioner rejects this comment. He has, in fact, carefully considered the costs of compliance and determined them to be justified by the need for effective rate-regulation of this industry with over $4 billion in California revenue. He has also carefully considered the comments submitted in this file regarding the costs of compliance. The commenter has not identified any empirical data or analysis the Commissioner should consider that he has not considered, and the commenter has proffered no evidence of probative value on the cost of compliance.

Summary of Comment (page 15):

Government Code section 11346.3 requires the Commissioner to assess the potential for adverse economic impact on businesses and individuals, including the impact on business' competition relative to businesses in other states. Thus, prior to proposing the regulations, the Commissioner was required to solicit information from the title and escrow industries, concerning the impact on business in other states. The commenter is unaware of any request by the Commissioner for the regulated entities to provide such information. The Commissioner has, accordingly, failed to comply with Government Code section 11346.3.

Response to Comment:

The Commissioner rejects this comment. The Commissioner is, in fact, considering any comments he receives regarding the impact of the proposed regulations on the ability of California businesses to compete with businesses in other states. This commenter has tendered no such information. Furthermore, it is not clear how the proposed regulations could have any effect in this industry, since out-of-state companies are not authorized to write title insurance in California and the regulations only apply to the companies' California business. Nor has the commenter tendered any evidence of any existing or potential interstate competition in title or escrow markets.

Summary of Comment (page 15-16):

The proposed regulations violate Government Code section 11346.3, which requires an agency proposing to adopt a regulation to assess the extent to which it will affect the creation or elimination of California jobs, the creation or elimination of existing California businesses, and the expansion of California businesses. While the Commissioner recognizes an impact in his rulemaking file, he does so in conclusory terms and has not properly assessed the magnitude of the impact. The proposed regulations will substantially decrease revenue for each of the companies, while at the same time, increasing the time and expenses necessary to collect and report data. While the commenter has not had sufficient time to fully assess these costs, it is clear that even the cost of properly assessing these costs would be substantial. This is exacerbated by the fact that the California real estate market is in a downturn. Thus, the commenter expects that reductions in workforce and branch office closures are likely, which would ironically decrease competition.

Response to Comment:

The Commissioner rejects this comment. The Commissioner has considered the impact on jobs in California. What the commenter does not acknowledge is that the proposed regulations are designed to prohibit rates that would not prevail in a competitive market. It is entirely possible that such rates currently exist and that bringing them down to the levels that a competitive market would produce will reduce revenue. It may also be the case that it will reduce employment in the regulated industry. But there is no ground in law or sound policy why excessive rates should be maintained simply because the companies collecting them may use some of the excess to employ people who might not have been employed in a competitive market. On the contrary, job-elimination is not a recognized defense to excessive rates under the Insurance Code.

Summary of Comment (page 16-17):

Because various new issues have been raised which concern the length and complexity of these regulations and various material and statutory violations have been identified, the commenter requests that the Commissioner continue the rulemaking hearing for 60 to 90 days so that the Commissioner can properly consider the issues presented in this comment as well as those issues presented by other members of the public. This procedure is permitted by Government Code section 11346.8(e), which provides that the Legislature intends for agencies to consider granting a request by a member of the public for additional time if granting the request is practical and will not unduly delay action on the regulation. The commenter, accordingly, formally makes such a request.

Response to Comment:

The Commissioner rejects this comment. As the volume of this rulemaking file attests, these regulations have been the subject of voluminous comments by numerous members of the industry and the general public. The commenter has not identified any statutory violations in the proposed regulations and has not specified what necessary comments could be provided with additional time that could not have been made during the statutory 45-day comment period.